

**Annex 3:**

**German Ministry of Economics Position Paper**

# **Fundamentals of telecommunications**

## **1. Preliminary remarks**

Since the complete opening of the telecommunications market at the beginning of 1998, competition in Germany in this sector has developed in a very positive way. In Germany sector-specific regulation thus has proved to be an adequate instrument for the transition from a monopoly to competition. The Federal Ministry of Economics and Technology (BMWi) is confirmed in its assumption by the reports of the Monopoly Commission and the Regulatory Authority for Telecommunications and Posts (RegTP).

Due to the growing competition intensity, existing market-dominating positions are gradually being abolished and thus the regulation intensity is expected to be reduced in important parts of the telecommunications field.

In view of the extremely positive market development in Germany and the change in the international competition environment (international mergers, globalisation, commitment of large foreign firms in Germany), the BMWi is at present examining whether and in how far there exists overregulation that must be abolished by means of the modified application of rules in the short term or through the amendment of the legal framework in the medium term (end of 2002/ beginning of 2003). Within the framework of this examination, especially the experiences of other countries whose markets have been open for a number of years must be taken into account.

In the course of the review of the national legal rules, the present discussion on new provisions at the European level (review discussion) must also be taken into consideration.

Against this background, the BMWi is constantly examining the need for action, but at present sees no reason to change the national legal framework.

## **2. Evaluation of the recommendations of the Monopoly Commission (cf. Annex)**

**The positions regarding the assessments and recommendations of the Monopoly Commission. The individual positions reflect the present discussion in the BMWi.**

**Ad numbers 70 to 72:** The BMWi shares the assessment of the Monopoly Commission that the competition intensity has so far been low on the markets for local calls and subscriber lines. The alternative access technologies (wll, DECT, xDSL, broadband cable), together with a rise in demand for broadband network provision and the possibility to access the subscriber line of Deutsche Telekom, have the potential to perceptibly intensify competition. But this also requires regulatory measures.

**Ad numbers 70 and 73:** The BMWi agrees with the assessment of the Monopoly Commission that the market for long-distance and international calls is characterised by greater competition intensity than the market for local calls, largely due to regulations. But unlike the Monopoly Commission, the BMWi believes that competition on certain markets is already functioning. In these cases, the Telecommunications Act (TKG), pursuant to which regulatory measures usually depend on the existence of market-dominating positions, provides for an automatic reduction of regulations.

**Ad numbers 74 and 75:** The BMWi shares the opinion of the Monopoly Commission that an ex-ante regulation of the upstream markets is necessary as long as alternative carriers depend on the network infrastructures and other essential services of Deutsche Telekom. The BMWi, however, supports the idea that the interconnection obligation should **in the medium term** continue to exist only for market-dominating enterprises, accompanied by the respective amendment of the Telecommunications Act, in order to avoid overregulation. But special rules for subscriber network operators (fixed network and mobile communications) are also necessary.

**Ad numbers 74 to 76:** Unlike the Monopoly Commission and the RegTP, the BMWi believes that the ex-ante regulation of final customer prices, at least with regard to business customers, can also be abolished **in the medium term** and be replaced by retrospective abuse control carried out by the RegTP. In this case, the ex-post abuse control, which is so far limited to the ex-

amination of hindering measures and discrimination, would have to be supplemented by the control of price levels.

**Ad number 77:** Although the risk of abusive price levels has become insignificant in large parts of the markets as regards international and long-distance calls due to the great competition intensity, the BMWi also thinks that contestable markets do not yet exist in this field, since the pre-conditions underlying this concept (no sunk costs; the established company can react to market entrances only with delays) are not fulfilled especially without regulations.

**Ad number 78:** The BMWi at present sees no need for action regarding the framework conditions for the regulation of charges. Within the framework of the application of the rules, it must, however, be ensured that the scope of action of enterprises is restricted only as far as absolutely necessary. The built-in flexibility provided for in the Telecommunications Act presupposes that markets are adequately delimited in terms of contents and geography. Cf. also the remarks on numbers 74 to 76.

**Ad number 79:** The BMWi regards modified, sector-specific regulation that is adjusted to the competition development rather than the exclusive application of the general competition law as medium-term alternative to sector-specific regulation. In the long term, however, this sector must also be subject to general competition law. Against this background, the BMWi regards its proposals made with regard to numbers 74 to 76 as adequate.

### **3. Short-term need for action**

**Apart from the measures that are necessary in the medium-term, the BMWi believes that action is required also in the short term in order to make full use of the potentials of the telecommunications market. The BMWi proposes the following measures:**

**a) Market delimitation:** Due to the market conditions on various upstream and final user markets, the BMWi regards a stricter delimitation especially of markets that are relevant in geographical terms as necessary. The BMWi suggests that the RegTP should elaborate, in agreement with the Federal Cartel Office, - regardless of specific proceedings and in accordance with European rules – principles for the delimitation of telecommunications markets (upstream and final user markets, incl. mobile communications) both in terms of contents and geography. The Mo-

nopoly Commission also points out (numbers 11 and 12 of the Expert Report) that due to the differing competition conditions in the various regions it is necessary to delimitate the markets in order to be able to better evaluate the developments of the market shares on the markets that are relevant with regard to contents and geography.

**b) Optimisation of regulation procedures:** The work of the RegTP has created the basis for intensive competition on the German telecommunications market. In order to further enhance the transparency and the reliability of regulation decisions, the BMWi believes that it is necessary that the RegTP – like the British and American regulatory authorities – should to a greater extent than so far publicly discuss fundamental aspects (e.g. collection, cost-price gap) on the basis of fundamentals, taking account of the present and future market developments.

**c) Extended validity of licences:** In order to avoid unnecessary costs related to regulation especially to the detriment of the market and Deutsche Telekom, the RegTP should fully exhaust its legal possibilities with regard to the period of the validity of licences.

**d) Definition of essential services:** In view of the central role of the rules on special control of abuse and interconnection, the legal certainty on the market as well as the transparency of regulatory decisions should be as great as possible. Therefore, the BMWi suggests that both the services that are to be classified as essential pursuant to section 33 of the TKG and the services that are to be rendered within the framework of interconnection are listed in a catalogue by the RegTP, published for comments and regularly updated.

## **Annex**

### **Summary and recommendations of the Monopoly Commission\***

70. Nearly two years after the complete liberalisation of telecommunications in Germany, functioning competition on the markets for voice telephony in the fixed network does not yet exist. In the opinion of the Monopoly Commission, this applies to both the markets for local calls and subscriber lines and the markets for long-distance and international calls. So far the scope of action of the former monopolist Deutsche Telekom AG is not sufficiently controlled by structural competition.

71. Competition intensity on the markets for local calls and subscriber lines has been low so far. On the basis of an almost unchallenged infrastructure monopoly, Deutsche Telekom AG continues to have a dominating market position both as regards local calls as well as subscriber lines. Alternative offers of new carriers have so far been limited to conurbations and usually to business customers. Private customers continue to be largely excluded from competition.

72. In the opinion of the Monopoly Commission, there are three main reasons for the lack of competition concerning local networks. First the market entry costs. Due to necessary investments in network connections and the cost- and time-consuming acquisition of customers, they are much higher for local networks than on the market for long-distance calls. In addition, Deutsche Telekom AG as the dominating operator of subscriber lines is in a position to influence the costs of the market entry of new providers. Especially since it determines the modalities of switching. The incentive to make use of such potentials to hinder competitors is great. Their existence is already a deterrent for potential new providers. Second, the price of unbundled access to the subscriber lines restrains competition. According to a decision taken by the Regulatory Authority, it is higher than the charge that final users pay to Deutsche Telekom for network access. Market entries of new providers are not prevented by that fact, but they tend to be made more difficult. Third, there are at present no alternatives to the existing telecommunications network to offer voice telephony services in the fixed network. Alternative access technologies such as the wireless local loop, the use of electricity networks and the existing television cable network as access to the end user will only in the medium and long term contribute to an intensi-

fication of competition in the local network. In the short term, the potential impact on competition is also very small as long as the technical and economic prospects of these technologies are uncertain.

73. From the Monopoly Commission's point of view, there is so far no functioning competition without regulation on the markets for long-distance and international calls. The competition intensity is perceptibly greater on these markets than in the local network, but only primarily due to regulation. The basic provisions of the Telecommunications Act, namely the rules on the choice of the core network operators and on interconnection as well as the early decision of the regulator regarding interconnection charges, have a great impact on the market development. The resulting competition has no structural basis and thus is not secured. Its intensity depends on the continuation of regulation. In spite of its market share losses in the initial phase of competition, Deutsche Telekom AG continues to have a market-dominating position on the markets for long-distance and international calls. Apart from the market shares that are still high, this is also reflected by other criteria such as the financial power or the privileged access to procurement and sales markets. This is added by the omnipresence and the dominating position of Telekom on all upstream and final user markets of fixed network telephony. It lost market shares in the fields of long-distance and international calls especially in the first year of competition. It would have been possible to restrict these losses if Telekom had earlier reacted to the price competition. Since it has cut its tariffs for long-distance calls, it has controlled the market also because the scope for more competition is becoming smaller as the difference between final user prices and interconnection charges is diminishing. Thus the competitive edge of call-by-call providers no longer exists. „Their“ customers may return to Telekom. Owing to its collection function, Telekom continues to be in contact with the customers and have detailed information about the market which it uses when facing its competitors. Besides, only a few companies exert a sustained competition pressure on Deutsche Telekom AG. These companies have decided to create an alternative, possibly nation-wide infrastructure and have succeeded in gaining business and regular private customers. Providers without networks of their own, without an established clientele worth mentioning and with a limited range of products are getting under increasing pressure as the market develops. If they do not succeed in purchasing transmission networks and in expanding in order to compensate for falling margins, they will very rapidly be forced to exit the mar-

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\* Monopoly Commission, Special Expert Report 29: „Wettbewerb auf Telekommunikations- und Postmärkten?“ („Competition on Telecommunications and Posts Markets?“), Baden-Baden 2000, p. 51 ff.

kets. The impact in terms of competition of the current consolidation process on the telecommunications markets is not yet foreseeable.

74. The legislator has provided for sector-specific regulation in the field of telecommunications, especially the regulation of charges, as a transitional concept. It is no longer necessary as soon as competition is functioning on the telecommunications markets. This is not yet the case. The Monopoly Commission believes that considerations to partly or fully exempt the former monopolist Deutsche Telekom AG from regulation are premature. In its opinion, the ex-ante regulation of charges both on the upstream and the final customer markets of fixed network telephony continues to be necessary.

75. The regulation of the mostly monopolised upstream markets is indispensable as long as alternative carriers exclusively depend on the network infrastructures and other essential upstream services of Deutsche Telekom AG. This applies in particular to access to interconnection services. They are the major cost factor for the new providers. Abolishing the ex-ante control of these and other upstream charges would enable Telekom to considerably influence the cost structures of its competitors.

76. The preventive regulation of charges on the final customer markets should under the present conditions avoid cross subsidisation and price dumping that restrain competition. Such strategies aim to crowd out and discipline existing competitors and hinder the market entry of potential new competitors. The incentive for market-dominating companies to make use of such hindering potentials is great. Efficient control is difficult since optional tariffs, discounts and similar means offer various possibilities to conceal price dumping. Therefore the Monopoly Commission at present regards it as indispensable to maintain the regulation of final customer prices in addition to the regulation of charges on the upstream markets as a „safety network“.

77. The objection that the regulation of the final customer markets was inefficient since the markets for long-distance and international calls were „contestable“ as defined by economic theory is not justified. According to this concept, price dumping strategies are irrational because after the successful crowding-out of existing competitors the price-fixing scope of the company which dominates the market is efficiently controlled by potential competition. This is not the case on the markets for long-distance and international calls. The conditions of the contestability of a market pursuant to the theoretical concept – largely free entry and exit of a market, delayed

possibilities of the company dominating the market to react to market entries – are not really fulfilled without regulatory measures.

78. At present the Monopoly Commission sees no need for action as regards the regulation of charges. In view of the risks for the further development of competition on the telecommunications markets, this instrument is for the present indispensable. Besides, the Telecommunications Act establishes a link between the regulation of charges and the existence of a market-dominating position. If the latter does not exist, regulation automatically does not take place. Thus an amendment of the Act is not necessary.

79. The application of the general competition law would be the alternative to the sector-specific regulation of charges. The control of abusive pricing practices under cartel legislation concerning interconnection charges is connected with conceptual problems and often enforceable only within the framework of lengthy proceedings. This would face the competitors with considerable uncertainties and jeopardise the development towards functioning competition.

**Annex 4:**

**Press and Trade Journal Materials**

**Deutsche Telekom's local loop investigated by regulator on competition grounds**

11/23/2000

AFX News

(c) 2000 by AFP-Extel News Ltd

FRANKFURT (AFX) - Deutsche Telekom AG's local loop is to be investigated on competition grounds by the German Regulator for Telecommunications and Post (**RegTP**), **RegTP**'s Klaus **Scheurle** said in an interview with daily Handelsblatt.

"It is possible to get the impression that Deutsche Telekom is deliberately attempting to keep rivals out of the market," said **Scheurle**.

A ruling is expected in mid-February, he said.

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## Deutsche Telekom Calls Regulator's Remarks Unjustified

11/23/2000

Dow Jones International News

(Copyright (c) 2000, Dow Jones & Company, Inc.)

BONN, Germany -(Dow Jones)- Deutsche Telekom AG (DT) said Thursday remarks from Germany's telecommunications regulator that it suppresses competition are "not at all justified."

"We adamantly reject the accusations," said Telekom spokesman Ulrich Lissek, referring to comments from the head of the German regulatory office in Thursday's Handelsblatt.

"There are times when one gets the impression that Telekom must be making a concerted effort to keep potential competitors out of the market," regulatory authority head, Klaus-Dieter **Scheurle** said in an interview with the German-language paper. He said he wants to find ways to free up local networks to move further away from a former monopoly system controlled by Telekom in the past.

But Telekom described the local network market as "just as free as the rest of the market." Lissek said the problem is at rival companies and doesn't have anything to do with Telekom.

"They can't make accusations against us because they don't want to invest," Lissek said.

Three companies - QSC, Riodata, and Colt Telecom - requested the regulator facilitate connections for their networks in urban areas through Telekom's main local distributors. For this, they must use their own technology in the so-called "collocation areas," where individual networks overlap.

Company Web site:<http://www.telekom.de>

Regulator Web site: <http://www.regtp.de>

-By Beth Reigber, Dow Jones Newswires; 49-69-2972-5500; [beth.reigber@dowjones.com](mailto:beth.reigber@dowjones.com)

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**GERMANY: German regulator's departure removes Telekom thorn.**

By Paul Carrel

11/24/2000

Reuters English News Service

(C) Reuters Limited 2000.

FRANKFURT, Nov 24 (Reuters) - The resignation of the head of Germany's telecoms regulator removes a thorn from the side of former monopoly Deutsche Telekom AG but it is unclear whether the body's tough pro-competition line will change, analysts say.

Since being appointed president of the **RegTP** regulator in 1998, Klaus-Dieter **Scheurle** has issued a series of rulings which have allowed alternative carriers to compete with Telekom at cut-price tariffs using the former monopoly's network.

The opening up of the network has cut into Telekom's earnings from its traditional fixed-line business and drawn persistent criticism from Ron Sommer, chief executive of the leading German telecoms operator.

"**Scheurle** has given Deutsche Telekom quite a hard year so far," said Holger Grawe, fund manager at WestLB AM in Duesseldorf.

Just last week, **RegTP** dealt a double blow to Telekom and its T-Online Internet service provider unit, dishing out rulings that stand to raise T-Online's costs, lower those of its rivals and cut into Telekom's revenue stream.

**SCHEURLE'S NUMBER TWO SEEN TAKING OVER**

The German economics ministry's announcement on Thursday that **Scheurle** will step down by the end of the year could result in an improved regulatory environment for Telekom, experts say.

"The prospects of an improving situation for Deutsche Telekom may be slightly better than the status quo right now, depending on the successor," said Grawe.

Industry sources expect **Scheurle**'s successor to be **RegTP** Vice President Matthias Kurth, though the new president will be appointed by the government.

Although the head of the regulator's office is an independent civil servant, appointments are generally seen as being influenced by political affiliations.

**Scheurle**, appointed by the previous conservative government, is a member of the Bavarian Christian Social Union, while Kurth, a former state secretary in the Hesse economics ministry, is a member of the ruling Social Democratic Party.

Industry sources said an appointment of Kurth would not lead to any significant change of course by the regulator's office, which has vigorously sought to break down barriers to competition, but analysts say the finance ministry has been concerned by the pressure on Telekom's share price created by some of **Scheurle**'s recent decisions.

"Unlike **Scheurle**, his successor is expected to take decisions which are more Telekom-friendly in order to mitigate the pressure on Telekom's share price," Theo Kitz, analyst at German private bank Merck Finck & Co, said in a research note.

Telekom shares were 2.96 percent higher at 39.99 euros by 1200 GMT, slightly outperforming a rise of 1.53 percent on the blue-chip DAX index.

But the stock is trading only slightly higher than its October 12 year low of 35.01 euros. It has been pummelled lower this year, now trading at around 38 percent of its March 6 year high of 104.90 amid worries about the company's profitability.

Merck Finck's Kitz, who rates Telekom a "market performer", said the fall in the share price "obviously has worried (Finance Minister) Hans Eichel, the representative of Telekom's majority shareholder (the German government)."

The German government currently has a 58.2 percent in Telekom. Once the Bonn-based group has taken over U.S. cellphone operator VoiceStream, which is expected next year, its stake will be reduced to around 45 percent.

BULK OF LIBERALISING ALREADY DONE

Whoever takes over from **Scheurle** will become chief watchdog of a telecoms market where a significant degree of liberalisation has already been implemented - **Scheurle** has implemented most of the reforms which could hurt Telekom.

"The significant market decisions since the liberalisation have been taken," said Ralf Hallmann, analyst at Bankgesellschaft Berlin, who has an "accumulate" rating on Telekom.

One area the **RegTP** still has the chance to liberalise is the local phone network in Germany, where Telekom has control of the "last mile" of access.

Telecoms operator Debitel AG said on Thursday the **RegTP** had begun proceedings, at its request, to open up Telekom's local phone network. The next **RegTP** president may well issue the ruling on this issue.

**Scheurle**, who supervised the auction of new generation mobile phone licences which netted the government almost 100 billion marks (\$43.08 billion) in the summer, is to take up a consultancy job at Credit Suisse First Boston, the investment bank said on Friday.

A Deutsche Telekom spokesman said the group was "surprised" by news of his resignation.

(Additional reporting by Hendrik Sackmann in Frankfurt).

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**GERMANY: D.Telekom plans massive opposition to flat-rate ruling.**

11/25/2000

Reuters English News Service

(C) Reuters Limited 2000.

FRANKFURT, Nov 25 (Reuters) - Deutsche Telekom AG will take "massive action" against a ruling by the German telecoms regulator last week requiring it to offer unmetered flat-rate Web access for Internet service providers, its CEO told Der Spiegel magazine on Saturday.

"Exactly what the regulator is demanding is not yet totally clear to me. But if my fears are correct, it's a question of a quasi-expropriation of Deutsche Telekom, and we're going to take massive action against that," Ron Sommer was quoted as saying.

He did not specify what kind of action Telekom would take.

The decision on unmetered flat-rate Web access starting on February 1 next year is seen lowering the cost base of rivals to Telekom's T-Online AG Internet service provider such as AOL Germany and Freenet.de .

Last week regulator **RegTP** also said Telekom must stop giving bulk discount rates for access to its telephone network from December 15.

Sommer told Der Spiegel that German regulatory decisions were creating unfair conditions in the firm's competition against major rivals such as British Telecommunications Plc and France Telecom .

"Our market value would be dramatically higher if we had fair conditions," he said.

Analysts, however, have said the German economics ministry's announcement on Thursday that telecoms regulator Klaus-Dieter **Scheurle** would step down by the end of the year could result in an improved regulatory environment for Telekom.

Since being appointed President of the **RegTP** regulator in 1998, **Scheurle** has issued a series of rulings which have allowed alternative carriers to compete with Telekom at cut-price tariffs using the former monopoly's network.

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**Foreign telecom cos reportedly fear new protectionism on Scheurle departure**

11/26/2000

AFX News

(c) 2000 by AFP-Extel News Ltd

FRANKFURT (AFX) - Foreign telecoms companies are fearful of a new era of protectionism in the German telecommunications and postal markets now that Klaus **Scheurle**, the head of the German Regulator for Telecommunications and Post (**RegTP**), has resigned, German weekly Focus reported, citing a high-ranking **RegTP** official.

There was a series of "worried phonecalls" from U.S. companies following news of **Scheurle's** resignation, the magazine quoted the official as saying.

The new president of the authority, Matthias Kurth, will only be appointed if his decisions on flat-rate internet access charges and on the local loop are in favour of Deutsche Telekom AG, and if he agrees to a possible extension of Deutsche Post AG's monopoly beyond 2002, the magazine said, without citing sources.

scs/pav/ For more information and to contact AFX: [www.afxnews.com](http://www.afxnews.com) and [www.afxpress.com](http://www.afxpress.com)

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**GERMANY: ANALYSIS-D.Telekom takes long view on Internet charging.**

By Paul Carrel

12/08/2000

Reuters English News Service

(C) Reuters Limited 2000.

FRANKFURT, Dec 8 (Reuters) - Lose the battle, win the war.

That seems to be the thinking behind a U-turn made by Deutsche Telekom AG in its stance on offering wholesale flat-rate access to its network for Internet service providers, analysts say.

Chief Executive Ron Sommer vowed only last month to fight a ruling by Germany's **RegTP** telecoms regulator which required the group to offer ISPs unmetered Internet access using its network from February 1 next year.

But Sommer said on Thursday Telekom would offer a wholesale flat rate "more quickly than expected" and company sources said the German telecoms giant could come up with a flat-rate offer by the end of this year.

"It's a complete turnaround," said Theo Kitz, analyst at Merck Finck & Co in Munich.

But by appearing to give ground on the flat-rate ruling, Telekom might smooth relations with the **RegTP** regulator and get a better deal in the future, analysts said.

The timing is canny too - the **RegTP** is about to undergo a change in leadership and Telekom will be eager to start out on good terms.

"Sommer's trying not to put himself at odds with the regulator. He wants to create some harmony," said Josef Scarfone, fund manager at Frankfurt Trust.

#### LOOKING AT THE BIG PICTURE

Crucially, the ruling on wholesale flat-rate access only applies to Telekom's analogue and ISDN (Integrated Services Digital Network) lines.

"This old technology won't be so important in the future," said Hans Huff, industry analyst at Bankgesellschaft Berlin.

Telekom has invested heavily in expanding its potentially speedier ADSL (asymmetrical digital subscriber line) network. This offers a much faster connection than ISDN and with it the possibility, for example, of watching high-quality video pictures online.

Analysts expect Telekom to mount a hefty advertising campaign next year to move Web surfers onto ADSL, where they say Telekom stands to make decent profit margins.

Sommer is eager that the **RegTP** does not force Telekom to offer a wholesale flat rate on the new standard.

By climbing down on the latest flat-rate ruling and appearing to cooperate with the regulator, Telekom may avoid a potential future ruling on a wholesale flat rate for ADSL.

"Sommer has the big picture in mind," said Merck Finck's Kitz. "They are making this compromise in order not to endanger their high hopes for returns on ADSL."

#### A FRESH START

Telekom is not guaranteed to make big money from ADSL. Much depends on how successful the group is in luring customers over to the new standard both via its T-Online unit and other ISPs.

"It will take time. It depends on the price," said Frankfurt Trust's Scarfone.

Avoiding the introduction of a flat rate on its ADSL wholesale tariffs would certainly help Telekom's profit margins with the new standard.

Telekom has been dealt a series of blows by outgoing **RegTP** President Klaus-Dieter **Scheurle**.

Industry sources expect **Scheurle's** successor to be **RegTP** Vice President Matthias Kurth, though the new president will be appointed by the government.

Analysts believe the finance ministry has been concerned by the pressure on Telekom's share price created by some of **Scheurle's** recent decisions.

The Social-Democrat led German government is Telekom's biggest shareholder, currently holding a 58.2 percent stake.

Kurth is a member of the ruling Social Democratic Party. **Scheurle** is a member of the Bavarian conservative Christian Social Union.

Telekom shares are currently trading at around 37 euros - some 65 percent off their year high of 104.90 euros, set on March 6. (With additional reporting by Hendrik Sackmann).

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## **Deutsche Telekom CEO Finds Time Is Against Him**

By William Boston

10/24/2000

The Wall Street Journal

Page C1

(Copyright (c) 2000, Dow Jones & Company, Inc.)

BONN -- **Deutsche** Telekom Chief Executive Ron Sommer never tires of saying he is out to please long-term investors, not those looking for a quick profit. It may be time for Mr. Sommer to rewrite his speech and speed up his timetable.

While many CEOs are under pressure to increase the value of their company's shares, Mr. Sommer is under more pressure than most. Indeed, much like AT&T's C. Michael Armstrong, Mr. Sommer has launched a costly and risky expansion strategy to compensate for shrinking revenue and profit in a onetime monopoly business that now faces fierce competition.

**Deutsche** Telekom's shares are down 40% since mid-June, and Mr. Sommer has about six months to arrest the decline -- or risk disconnecting the biggest deal of his career, the \$50 billion stock-and-cash acquisition, announced in July, of VoiceStream Wireless, the U.S. mobile-phone outfit.

Seven months ago, **Deutsche** Telekom shares peaked at 103.5 euros (\$87) a share. In June, the German government -- still the company's biggest shareholder -- sold shares at around 65 euros. Today, the stock is at 39.85 euros a share.

The decline has occurred for reasons both in and beyond Mr. Sommer's control. Even as the broader market has slipped, investors have specific worries about the German telephone giant. This much rings true: Time is not on Mr. Sommer's side.

If **Deutsche** Telekom shares continue to fall, the VoiceStream acquisition could unravel. **Deutsche** Telekom plans to trade 3.2 shares of its stock plus \$30 for every VoiceStream share, with no adjustment for minor ups and downs in **Deutsche** Telekom's stock price. But the companies agreed that if **Deutsche** Telekom shares trade at an average of 33 euros, or less, on seven randomly chosen days out of the 14 days prior to the closing, VoiceStream can renegotiate the deal or walk away. Regulatory clearance probably will delay a closing until the second quarter of next year.

A **Deutsche** Telekom spokesman said the company remains confident that the VoiceStream deal will close as planned. Although earnings have weakened, the spokesman said opportunities from growth in the company's online and mobile-telephony business should help improve overall profit after a "dry stretch," which he declined to elaborate on. VoiceStream couldn't be reached for comment.

Another potential problem is that **Deutsche** Telekom is looking overvalued even with the stock price's decline. Analysts estimate that, using U.S. generally accepted accounting

practices, the company is trading at about 25 times its earnings over the past 12 months, a hefty multiple when the profit picture is cloudy at best.

Moreover, after years of cutting liabilities, **Deutsche** Telekom is back to taking on new debt and thus additional interest payments to finance licenses and networks for next-generation wireless services in Europe. And on top of that, the deal with VoiceStream, a youthful company that is still building its network and has yet to turn a profit, is considered pricey by many investors and will dilute **Deutsche** Telekom's earnings (the company hasn't specified by how much).

The good news is that **Deutsche** Telekom's mobile-phone customer numbers are surging, and new services, to be provided when the next-generation wireless networks come online, are promising. But for now, actual revenue per customer is falling, new-customer acquisition costs are hurting profits, and profits from wireless services are years away.

And so, with competition on the rise, **Deutsche** Telekom is warning investors that margins in its core domestic telephone business -- which accounted for more than 50% of its profit and 68% of revenue in the year's first half -- are declining. In the first half, **Deutsche** Telekom reported net income of 4.35 billion euros, up from 951 million euros a year earlier. However, underlying profit fell 28% in the first half to 681 million euros, after taking into account extraordinary gains from the sale of its stake in its Global One corporate-communications venture with France Telecom and Sprint, as well as the initial public offering in April of its Internet unit, T-Online International.

Karl-Gerhard Eick, the company's finance chief, says the margin on earnings before interest, taxes, depreciation and amortization was 33.7% in the first half and would likely fall to 30% for the full year. Analysts will be looking for signs of progress when the company publishes third-quarter results, which are expected Oct. 31.

Mr. Sommer is also running into some static with his internal restructuring. A plan to list the company's wireless unit T-Mobile International on a stock exchange has been delayed pending the closing of the VoiceStream deal. The Internet unit, T-Online, Europe's largest Internet service provider, is struggling with a flagging stock price as well as management changes. While some in T-Online's management thought the unit's IPO was buying them freedom, investors are concluding that Mr. Sommer wanted an acquisition currency, not a Silicon Valley start-up in the heart of Germany. The executive who took T-Online public has quit; Mr. Sommer is replacing middle managers at the unit, and others are leaving for rivals. **Deutsche** Telekom officials decline to comment.

One winning move, analysts say, is Mr. Sommer's plan to restructure T-Online into a holding company with national subsidiaries. That will allow the units to respond more quickly to local markets. He is looking for a high-profile Internet executive to become CEO at the holding company.

**Deutsche** Telekom shares also have been hurt by the expectation that the German government will continue to sell its holdings in the company, flooding the market with shares. The government holds 43% of Telekom directly and has placed another 15% with a state-owned development bank.

To help **Deutsche** Telekom win U.S. regulatory clearance for the VoiceStream deal, the German government is promising to reduce its direct stake in the German telecoms firm to zero as quickly as possible. But with the shares slumping, one government official says, "There's no way we're going to sell."

Is this good or bad news? It could mean fewer shares coming to market next year. But the overhang remains a factor in market thinking, and the delay may make the VoiceStream deal a tougher call for U.S. lawmakers looking for a reason to block it.

People close to Mr. Sommer say there isn't much he can do except show investors that he is executing his strategy to focus the company on basic phone service, information-technology services, wireless and Internet services. He must also show that the international expansion remains on track. As he has used a series of small deals to make Telekom the largest regional phone company in Eastern Europe, analysts say more of these smart, cheaper, easy-to-digest moves might be a good thing.

And he must avoid mistakes, stabilize T-Online and promise no more dilutive VoiceStream-like acquisitions. That has essentially been the message that he and Mr. Eick brought to investors recently in the U.S. and Europe.

He also might consider buying up some of the government's stock and retiring the shares. This would help dilute the government's holdings and would help lift the share price by reducing the number of shares outstanding. But the company is strapped for cash and is borrowing so much to pay for the next-generation wireless infrastructure and services that earlier this month Standard & Poor's cut the company's long-term debt rating to A-minus from double-A-minus. So a share purchase isn't much of an option.

Meanwhile, the pressure on Mr. Sommer is rising. The brash executive doesn't have a lot of friends in Germany's center-left government. Some of the two million private individuals -- and voters -- who lost money when they invested in Telekom in June are writing angry letters to the government.

Some in the government would like to see Mr. Sommer go sooner rather than later. Until now, investor backing for the company's "Wunderkind" has kept the pols at bay. But if Mr. Sommer keeps investors waiting long, analysts say, he might run out of allies

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