Appendix III

ECOI
Electronic Communications
Office of Iceland

Main views of parties to national consultation and the position of the Electronic Communications Office of Iceland.

Cost analysis of wholesale prices for copper local loops

March 2023

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1 Introduction

(1) The preliminary ECOI draft decision on wholesale tariff for access to copper local loops and distribution frames was submitted to national consultation which lasted from 10 January until 9 February 2023.

(2) Submissions were received from Síminn hf. (Síminn) and Sýn hf. (Sýn). ECOI sent the submissions to Míla for comment. In Appendix II one can find the submissions from Síminn and Sýn in their entirety, along with Míla responses to the submissions.

(3) In the following section, ECOI has summarised the main points of view of Síminn and Sýn regarding the ECOI draft decision. Míla responses as specified where appropriate, and the position of ECOI. ECOI furthermore points out that in the draft decision, one can find answers to many of the comments submitted by Síminn and Sýn.

2 Síminn views

Síminn

Indexation of tariffs subject to obligations

(4) In the Síminn comments, the following is stated on page 1:

> "In ECOI comments accompanying the news item, it is stated that the intention is to increase the tariff for copper local loops from ISK 1,558 to ISK 1,978. The current price for copper connections was last changed on 1 June 2019, pursuant to PTA Decision no. 8/2019 which means a price increase of 27%. It is therefore clear that ECOI considers it normal to increase prices in step with indexation and this thus *constitutes an ECOI policy to index tariffs of undertakings that are subject to obligations*"

The position of the ECOI

(5) Síminn considers that ECOI is endorsing the indexation of tariffs subject to obligations. This is a misunderstanding. In the draft decision reference is made in section 2.1 to the text of ECOI Decision no. 5/2021, where it is clearly stated that the tariff for access to copper local loops shall be cost oriented and based on cost analysis, as further detailed in the section. This is largely in accordance with a prior market analysis decision by the Post and Telecom Administration (PTA) no. 21/2014. ECOI reviews Míla cost analysis as described in the draft decision, and can make changes to the analysis should the Administration consider that a specific cost results from inefficiency (see section 5.3.2 in the draft). Then ECOI can, when calculating costs, take into account operations of analogous service which is deemed to be efficiently operated. ECOI is also authorised to take into account the price on offer on comparable competition markets. ECOI (once PTA) has for many years examined the conclusion returned by a cost analysis with respect to index development between cost analyses and/or with price comparison with analogous service. This is done in order to prevent price increases being far in excess of the development of indices. This does not however mean that ECOI is endorsing that the tariff should increase automatically in accordance with indices. ECOI can take measures where the Administration considers that a specific cost results from inefficient operations and this was done by ECOI in this analysis with respect to hosting costs as is stated in section 5.3.2.

(6) A new approach was however presented in the ECOI Decision no. 5/2021, that authorised an annual increase of tariff with indexation, less an efficiency requirement to be decided by ECOI between the making of cost analyses to decide price on the basis of cost. The purpose of this was to increase predictability and stability in local loop price, and as is stated in section 5.9.3, ECOI considered that it was not timely to decide the efficiency requirement in question, as it was clear that Decision no. 5/2021 needed to be reviewed before 15 September 2023, i.e. before the increase was to come into force. It is therefore not the case that the Míla tariff will increase automatically with indexation while Míla was subject to its tariff being cost oriented. On the other hand, the obligation will be reviewed in the ECOI market analysis that is being conducted by the Administration at this point in time.

Síminn

Costs for operating copper local loops

(7) In section 2.2 in the Síminn comments there are references to article 52 of the Electronic Communications Act, and the undertaking points out that investments should be taken into account and encouraged. Then Síminn states:

> "Síminn considers it doubtful that the cost of operating copper local loops has increased by 27% from the year 2019."

The position of the ECOI

(8) It is not stated in the cost analysis that costs had increased by 27% since the year 2019. Costs have decreased compared to the costs on which the prior cost analysis was based. Sold units have on the other hand decreased quite considerably and costs have not decreased to the extent that the unit price has remained the same.

Síminn

ECOI Decision no. 5/2021 rescinded in part

(9) In section 3 in the Síminn comments, the undertaking points out that ECOI Decision no. 5/2021 is the basis for the obligations that rest on Míla and that the decision had been rescinded in part.

The position of the ECOI

(10) As is specified in section 2 in the draft decision, the amendments decided by Appellate Committee for Electronic Communications and Postal Affairs do not relate to obligations on price control for access to copper local loops, to fibre in street cabinets, to VULA on copper local loops and to facilities related to local access to copper local loops. ECOI does not see the purpose of this comment from Síminn in this context The decision is in force with respect to copper local loops and it is therefore normal to base a planned decision on tariff for copper local loops on the decision in question.

Síminn

Increases in excess of indices and use of the building cost index

(11) On page 3 in its comments, Síminn submits a table with price changes and indices. Síminn points out that the price increase in 2019 constituted an increase in excess of the consumer price index and the building cost index and that this also applies now. Síminn also objects to increases for service based on investments that have to a large extent been written off and to service that is scheduled for decommissioning in the coming years. Síminn also objects to using the building cost index as grounds for copper connections that have not been installed in Iceland for many years and where the objective is to decommission the copper system in the coming 2-3 years. Síminn then refers to increases for fibre supplied by Ljósleiðarinn, Míla and Tengir for comparison.

Míla replies

(12) In the Míla responses the following is stated :

> "All of the criteria for the cost analysis, including indexed *historical cost* in copper infrastructure in the context of useful life of investments are reasonable grounds for assessment of modest return on investment and are within the instructions in article 52 of the Electronic Communications Act no. 70/2022, with the addition of the fact that appropriate harmonisation with prior ECOI administrative decisions is respected. In the above specified context, it is perfectly logical and normal to take into account the *building cost index* in order to index an investment, as that index is considered to best reflect price development where a large part of the investment is in civil works and this index is furthermore a recognised metric in this country for cost indexation.
>
> It is not abnormal that the charge should increase somewhat more than the consumer price and building cost indices for the period 2017-2021. The increase is furthermore less than the development of the building cost index until 2022, as pointed out by ECOI, and in addition to this the *wages index*, which by the nature of things is a large and important variable, has increased significantly since the last cost analysis.
>
> Increases in excess of the price for fibre connections can largely be attributed to a lower *utilisation ratio*. Míla copper local loops decreased by about 20% in 2021, and as can be seen in the cost analysis, copper local loops decreased from 120,000 to 47,000 during the years 2016 to 2021. This decrease is non-transitory and copper local loops decreased by about 12,000 during last year. Revenue from copper connections has decreased rapidly at the same time, and will continue to do so.
>
> One must also take into account the fact that where fibre uptake is complete, in a very few and furthermore low-population municipalities, Míla was, hand in hand with a decrease in copper connections and correspondingly poorer utilisation, *at the same time* obliged to maintain an extensive and expensive system."

The position of the ECOI

(13) As stated here above, the conclusion on price is based on cost analysis and the reference to corresponding increases in the building cost index and wages index is for the purpose of assessing whether there is a reason to reject the cost analysis. According to the draft decision,

ECOI decides to use the Míla cost analysis as grounds, but with those amendments proposed by ECOI during case procedure.

(14) As stated in the analysis, capex is 68% of total costs against 32% opex. As the building cost index best describes costs incurred in development and maintenance of the copper system, ECOI has used that index both in indexation of costs and to assess the conclusion on price. The building cost index is based among other things on costs of cabling materials and civil works. The wages index is also taken into account as 32% of costs are opex, which is mostly based on wages costs, though hosting costs is also a major factor here. ECOI does not however take into account the consumer price index in this context, as consumer products do not have a significant impact on costs of operation and maintenance of the copper system.

(15) In ECOI discussion in section 5.8.2, the year 2017 is taken into account when the building cost index is examined, as this was the operational year on which the prior local loop price was based. The local loop price did not however come into force until 1 June 2019 as indicated by Síminn. If one considers the increase in the building cost index from that date until January 2023, it increased by about 23% while the wages index increased by about 31%. It is also important to note in this connection that the increase in the local loop price without the impact of the discontinuation of the setup fee is 25%, and in addition to this the coming into force is not until two months after Míla will notify this price change. ECOI considers there to be no reason to reject the Míla cost analysis, though it returns a conclusion that means that the increase from the time that the current price came into force is rather more than the increase in the building cost index from that time. ECOI also refers to discussion in section 5.9.1 in the draft decision.

(16) With respect to the Síminn assertion that the intention is to decommission the copper system over the next 2-3 years, ECOI requested a response from Míla on this issue and received the following reply:

> "It has not been formally announced when the copper system will be closed, but the aim is to close the system within the coming 6-7 years. It is therefore not a correct statement that it will be decommissioned over the coming 2-3 years."

Síminn

Fibre transfer

(17) In the opinion of Síminn, there has been no delay in transfer from copper connections to fibre, and there is no indication that the pricing of copper today was having an impact on switching to fibre. It would be normal in cases where electronic communications undertakings neglected transfer from copper to fibre, that the price of copper be increased significantly in order to encourage more rapid replacement. If on-site service of the relevant infrastructure undertaking could however meet demand, it would not be normal to increase the price of copper connections.

(18) In the opinion of Síminn, the biggest issue was manpower to meet demand for switching to fibre and also access to consumers' properties, where consumers needed to provide access during working hours, which could be a challenge.

Míla replies

(19) In the Míla responses the following is stated :

> "There was no obstacle on Míla's part, including no shortage of manpower, to move customers from copper connections to fibre connections. Míla aims to quickly decommission copper connections and lacked no incentive to do this. ECOI has already been informed of this and it is established that ECOI has notified that it will request more detailed information on Míla plans in this respect.
>
> One must also take into account the fact that Míla does not have a commercial relationship with end users, but it is rather Míla customers, electronic communications undertakings on the retail market, that have this relationship. Their lack of action, or whatever other reasons may explain why end users have not in all instances switched, may not, by the nature of things, prevent Míla from receiving a normal and statutory return/profitability from their copper connections."

The position of the ECOI

(20) As stated in the draft decision, the tariff is based on the cost of providing the service. This is also the same price for the whole country, which is in accordance with ECOI Decision no. 5/2021. In the opinion of ECOI, there it is out of the question for the Administration starting to monitor uptake of fibre in each individual area and the capability of an infrastructure undertaking to meet demand for fibre connections, in order to decide the price for copper local loops in that area. In the opinion of ECOI, Síminn is on the wrong track with regards to how to encourage investments in high-performance high-speed networks in accordance with electronic communications legislation. ECOI considers it furthermore not conducive to investments in fibre in competition with copper local loops, to have the access price for copper local loops below the cost of providing the service.

(21) ECOI furthermore considers it not conducive to encourage Míla investment in fibre, to force the company to collect a fee which does not meet the cost of operating the copper system.

Síminn

Fibre transfer

(22) On page 4 of the Síminn comments, the following is stated:

> "It is furthermore important to keep in mind that at certain locations, copper is the only option, which means it is sensible to keep the copper price at a minimum, which would lead to an incentive to invest in fibre and thus be able to sell more expensive and better connections. When fibre is subsequently deployed, it would be possible to significantly increase the price of copper in order to accelerate both uptake and use of a more economic and better connection. Increasing the price of copper before the investment in fibre has been made is, in the opinion of Síminn, an ill-advised approach which leads to wrong incentives."

The position of the ECOI

(23) ECOI refers to the Administration's above specified replies, and to the fact that the draft decision is based on ECOI Decision no. 5/2021, where it is stated that the average unit cost

for the whole country shall be calculated on the basis of allocated opex and capex divided by the number of lines or their equivalents.

Síminn

Fibre transfer

(24) On page 4 of the Síminn comments, the following is stated:

> "Síminn pointed out that ECOI maintained that it was normal to increase the price of copper by 27%, because a price that was too low would lessen incentive for uptake of fibre. This seems to be a case of a significant misunderstanding by ECOI of real uptake of fibre in Iceland."

The position of the ECOI

(25) This is a misinterpretation by Síminn. The increase is because the development of cost per sold unit has increased and it is the conclusion of the cost analysis which decides the price, not an incentive for uptake of fibre. ECOI is here referring to the fact that if the Administration were to reject the conclusion of the cost analysis for the purpose of limiting the price increase, this could lead to the price being too low in comparison with fibre local loops, which could again lesson the incentive for electronic communications undertakings to switch to fibre local loops where they are on offer. In this connection one could mention as an example that in the capital city area[1] almost all households and companies have had access to fibre local loops for a number of years, but copper local loops are nevertheless 16% of leased copper local loops[2]. As stated in ECOI Decision no. 5/2021, it is the ECOI assessment that there is substitutability between copper and fibre local loops. Those electronic communications undertakings, like Síminn, that collect the same line fee for copper and fibre local loops have greater margin from line fees for copper local loops than for fibre local loops, which means that there could be in some instances an incentive to keep the undertaking's customers on copper local loops. This is however in no way a deciding factor in the ECOI conclusion on price; it is the cost analysis that decides. To impose price control on an undertaking is a burdensome measure, and when this is done, it is normal that the undertaking can recover costs incurred in efficient operations.

Síminn

Revaluation of historical cost of assets that have been written off

(26) On page 5 of the Síminn comments, the following is stated:

> "Síminn also wishes to note that it needs to be explained whether the cost analysis takes into account the fact that a significant part of the copper system has effectively been closed in those cases where fibre has been deployed and is already in use. Revaluation of historical costs of such connections should not be part of cost analysis, as this is service which is effectively closed and will not be sold or used. It is not clear how this impacts on the analysis and it needs to be explained."

[1] With the exception of Kjósahreppur.

[2] Based on figures from mid-year 2022.

Míla replies

(27) In the Míla responses the following is stated :

> "All of the criteria for the cost analysis, including indexed historical cost in copper infrastructure in the context of useful life of investments, are reasonable grounds for assessment of modest return on investment and are within the instructions in article 52 of the Electronic Communications Act no. 70/2022, with the addition of the fact that appropriate harmonisation with prior ECOI administrative decisions is respected."

The position of the ECOI

(28) As stated in the draft decision, capex is based on historical costs. It is therefore not a question of investments having been revalued as is done when the investment base is assessed on the basis of replacement cost. Historical cost is on the other hand, indexed with the building cost index as was done in prior cost analysis on the local loop market. When a tariff is based on historical costs, it is assumed that investments will be recovered during the useful life of the investment, which has been 20 years in the case of copper local loops, and not concurrently, as the local loop fee would then have been extremely high at the time when most investments were being made. This means that it takes a long time to recover an investment with local loop fees. In section 5.8.2 in the draft decision, there is a precise description of how the local loop price is calculated and then in section 5 there is a description of how the investment base is decided.

Síminn

Cancellation of setup fees pointless

(29) On page 5 of the Síminn submission, the following is stated:

> "At first glance, Síminn cannot see the point of cancelling setup fees, which leads to the monthly fee for local loop lease being ISK 31 higher. In this connection, Síminn draws attention to the fact that there should be no costs for setup fee for service which has been declared as being in the decommissioning phase. New registrations for copper local loops should instead be discontinued where fibre is available from Míla or fibre from suppliers that Míla has access to. In this manner, setup costs would probably be saved."

The position of the ECOI

(30) ECOI also refers to discussion in section 5.5 in the draft decision. Costs underlying new registration of local loops were not separated in the last cost analysis, and nor was this done in this analysis. In the last cost analysis estimated revenue from set-up fees were deducted from total costs while the set-up fee at that time remained unchanged. This is therefore only a question of the structure of the Míla tariff and of how costs are allocated to services, while the total cost does not change.

(31) With respect to Síminn opinion that new registrations should no longer be available, it can be said that decommissioning of the copper system is not under discussion in this draft decision. ECOI does not have information on when Míla plans to close for new registration for copper local loops and on how this will be arranged. An examination of this has been

commenced in a separate and independent case in connection with article 60 of the Electronic Communications Act no. 70/2022.

Síminn

Proposal on incentive for investment

(32) In section 6 of the Síminn comments, the following is stated:

> "In order to increase incentives for deployment of fibre in urban areas while at the same time encouraging uptake of fibre and thus the decommissioning of the copper system, Síminn makes the following proposal:
>
> a) Míla be authorised with a two-month announcement notice, to increase the price of copper local loops where another fibre undertaking has deployed fibre and where Míla has no possibility to offer fibre connections.
>
> b) Míla be authorised to increase the price of copper local loops where Míla has deployed fibre local loops and where the electronic communications company in question has *not* requested transfer to fibre local loops within two months of the notification of price increase.
>
> c) Míla be authorised to increase the price of copper local loops where no fibre local loop is available, and to be authorised to increase the price of copper when Míla has deployed fibre and the electronic communications company in question has *not* undertaken to move all of its customers to fibre local loops within 12 months from the time that the Míla fibre local loops were actively being sold."

Míla replies

(33) In the Míla responses the following is stated :

> "Síminn proposals, apart from the level of complexity in execution, are contrary to Míla statutory right to *reasonable profitability* from its products and services. Nor does this represent an objective and transparent measurement, including that decisions on tariffs "shall take into account advantages *of predictable and stable wholesale price*". If the price does not increase in accordance with planned changes, then this can lead to disincentive rather than incentive for end users to switch to fibre connections, contrary to the objectives of ECOI, of Míla itself and of article 52 of the Electronic Communications Act."

The position of the ECOI

(34) ECOI refers to prior replies here above and points out that the cost analysis here under discussion is based on the obligations imposed on Míla in ECOI Decision no. 5/2021. These Síminn proposals do not harmonise with the obligation for price control, which specifies that the access price for copper local loops shall be decided on the basis of cost and shall be the same across the whole country. At this point in time, ECOI is working on review of a market analysis of markets 3a and 3b as stated in the draft decision. When that market analysis is submitted for consultation, Síminn will have the opportunity to express an opinion on the planned changes that ECOI may propose to obligations.

3 Sýn views

Sýn

Cost increase of the copper system

(35) In the Sýn comments, the following is stated with respect to the planned price change for access to copper local loops:

> "Sýn hf. strongly objects to the planned Míla increase in tariff for access to copper local loops. It is quite remarkable that the Míla local loop system, that is to be phased out in the coming years, should be subject to such an enormous cost increase (27%), particularly when the system is being phased out and where investment in development of the system is very limited, even none, in recent years. For this reason one could have drawn the conclusion that the cost of operating the system was at an absolute minimum. "

Míla replies

(36) In the Míla responses the following is stated :

> "All of the criteria for the cost analysis, including indexed historical cost in copper infrastructure in the context of useful life of investments, are reasonable grounds for assessment of modest return on investment and are within the instructions in article 52 of the Electronic Communications Act no. 70/2022, with the addition of the fact that appropriate harmonisation with prior ECOI administrative decisions is respected."

The position of the ECOI

(37) As stated here above in reply to a comparable comment from Síminn, it is not maintained in the planned ECOI decision on tariff for access to Míla copper local loops, that opex has increased by 27% since 2019. Opex for copper local loops has decreased since the last analysis made by the Administration, but sold units on the other hand, have decreased significantly during the same period and total cost has not decreased to the extent that the unit price remains the same.

(38) One must also keep in mind that opex is 32% of total costs for access to copper local loops while capex is 68% which means that capex has a greater impact on the conclusion of the cost analysis than opex.

Sýn

The increase returns increased revenue to Míla

(39) In the Sýn comments the following is stated to the effect that the ECOI decision will return increased revenue to Míla, to the amount of ISK 158 million per annum.

> "A conservative estimate would show that the increase will return ISK 158 million per annum in increased revenue to Míla, on the basis of the number of xDSL connections at end of year 2022, according to ECOI data. Over a six-year period, this increase could return up to ISK 1 billion in increased revenue, from a system that bears minimum investment and that is technically obsolete and earmarked for decommissioning."

The position of the ECOI

(40) Despite Míla investment in copper infrastructure been minimal during recent years because the intention is to decommission the system, and opex also decreased significantly, the ECOI cost analysis is based on historical costs which allow for Míla recovering its investments during their lifetime, which is 20 years. The investment base in this cost analysis takes account of investments during the years 2003-2022. During the first years of this period, Míla made significant investments in copper infrastructure. The obligation for price control allows for Míla being authorised to recover these costs through the undertaking's tariff.

(41) ECOI raises objections to the Sýn calculation that over a six-year period the planned increase of Míla tariff can return up to ISK 1 billion increased revenue to Míla. In the Sýn calculation, it is assumed that the number of xDSL connections will be unchanged during the period, but the number of copper local loops, decreases rapidly, where copper local loops decreased from 120,000 to 40,000 during the years 2016 to 2021, as is stated in the Míla response. The decrease in copper local loops is a continuous process, where they decreased by about 12,000 during the last year according to Míla which means that it is not correct in the opinion of ECOI to calculate increased revenue for the coming 6 years on the basis of the number of copper local loops at end of year 2022.

Sýn

Míla investments have already paid for themselves

(42) In the Sýn submission, the following is stated with respect to Míla investments:

> "According to the table on page 14 of a Míla report one can clearly see that Míla stopped almost all investments in developing the system in 2021, but nevertheless projects significant increase costs in operating the system in the coming years. This is remarkable when one considers that investments in the Míla copper local loop system reach back to the year 1994, are at a minimum in the coming years, and should in all likelihood have already paid for themselves. It was also stated on page 10 in the same report that opex for the system has significantly decreased."

The position of the ECOI

(43) There appears to be a certain misunderstanding here on the part of Sýn, as despite the fact that the table shows a summary of Míla investments in the copper system from the year 1994 to the year 2021, not all of these investments form the basis for calculation of Míla tariff for access to copper local loops. Míla's cost analysis is based on the useful life of the investments being 20 years, which means that investments from the year 1994 until 2002 are not part of the Míla investment base for calculating tariff as the undertaking has recovered costs for these investments. In addition to this, investments during the year 2022 are taken into account on the basis of investments until October, but information was not available on total investments for the year 2022. By including the year 2022, the investment base decreased significantly as the year 2002 was then no longer part of the investment base.

(44) Despite the fact that opex has been decreasing, and that there had been a significant reduction in annual investments, this would not have sufficed to maintain the same unit price as local loops have decreased a great deal during recent years.

Sýn

Public works that have already paid for themselves

(45) In the Sýn submission, the following is stated with respect to public works that have already paid for themselves:

> "One could consider whether the Hvalfjörður road tunnel project represents an example of public works that could be seen in the same context as the Míla local loop system. An investment from the years 1996-1998 which has long since paid for itself and is now used without charge by the public."

The position of the ECOI

(46) ECOI refers to the Administration's reply here above and reiterates that the Míla investment base is on the basis of useful life of investments of 20 years, i.e. investments for the period 2003-2022. Míla investments in copper local loops during the last years are solely maintenance investments and not new investments and the undertaking has made efforts to keep opex at a minimum as the intention is to decommission the copper system.

(47) ECOI would also like to point out that despite access to the Hvalfjörður road tunnel being now free for the public, as that investment has paid for itself, there are still annual costs paid from the public purse that accrue from operation and maintenance of the tunnel.