Brussels, 1 December 2008
Case No: 61860
Event No: 499523

Póst- og Fjarskiptastofnun
Sudurlandsbraut 4
108 Reykjavik
Iceland

EFTA SURVEILLANCE AUTHORITY

For the attention of:
Mr Hrafnkell Gíslason, Director

Dear Mr Gíslason,

Subject: Comments pursuant to Article 7(3) of Directive 2002/21/EC regarding the Icelandic wholesale markets for:
- **Call origination on the public telephone network provided at a fixed location**
- **Call termination on individual public telephone networks provided at a fixed location**
- **Transit services in the fixed public telephone network**

I PROCEDURE

On 31 October 2008, the EFTA Surveillance Authority ("the Authority") received a notification of draft national measures in the field of electronic communications in accordance with Article 7 of Directive 2002/21/EC ("the Framework Directive" or "FWD")[1]. The notification was made by the Icelandic national regulatory authority for post and telecommunications, *Póst- og Fjarskiptastofnun* ("PTA"). It concerns three Icelandic wholesale markets as follows:

- Call origination on the public telephone network provided at a fixed location;
- Call termination on individual public telephone networks provided at a fixed location;
- Transit services in the fixed public telephone network.

These three markets correspond to markets 8, 9 and 10 in the list of markets contained in the Annex to the Authority's original Recommendation on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation adopted in 2004 ("the 2004 Recommendation").[2] On 5 November 2008, the Authority adopted a new Recommendation on relevant markets with a reduced list of markets susceptible to *ex ante* regulation.[3] The present notification was submitted prior to the

[1] Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services, as referred to at point 5cl of Annex XI to the EEA Agreement and as adapted by Protocol 1 thereto and by the sectoral adaptations contained in Annex XI to that Agreement.

[2] EFTA Surveillance Authority Recommendation of 14 July 2004 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services, as incorporated into the Agreement on the European Economic Area. The Recommendation was adopted by Decision No 194/04/COL.

[3] EFTA Surveillance Authority Recommendation of 5 November 2008 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with the Act referred to at point 5cl of Annex XI to the EEA Agreement (Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks

adoption of the Authority's new Recommendation, following market analyses of the three wholesale markets and consultation at the national level. Thus, the Authority has based its assessment on its 2004 Recommendation.

The national consultation process with market players in Iceland pursuant to Article 6 FWD was carried out prior to the notification to the Authority. There were two successive national consultations, due to the fact that the number of telephone network operators on all three markets decreased to two as a result of a consolidation of the market, and that new information on market share in the wholesale market for call transit in fixed public telephone networks (market 10) was submitted during the first national consultation. The first consultation ended on 13 May 2008 and three responses were received. The second consultation ended on 17 October 2008 and one response was received.

The Icelandic competition authority did not object to PTA's conclusions.

The notification consists of the following documents:

- Summary Notification Form, event 496815;
- Designation of undertakings with significant market power and draft decision imposing specific obligations in the markets for voice call origination, call termination and transit services on the fixed public telephone network ("the notified draft measure"), event 496818;
- Annex A: Analysis of the markets for call origination, call termination and transit services on the fixed network, event 496824;
- Annex B: Results from the consultation on PTA's notification of decisions in markets 8-10, event 496822.

The notification was complemented by additional clarifications submitted on 26 November 2008 (Event No 499878).

Pursuant to Article 7(3) of the Framework Directive, national regulatory authorities ("NRAs") in the EEA and the Authority may make comments on notified draft national measures to the NRA concerned.

The EEA consultation period under Article 7 of the Framework Directive expires on 1 December 2008.

II DESCRIPTION OF THE DRAFT MEASURE

II.1 Product and geographic market definition

On the basis of the market analysis, the Authority considers that PTA has not deviated from the market definitions of markets 8, 9 and 10 as laid down in the Annex to the Authority's 2004 Recommendation on relevant markets. PTA has defined the following relevant markets:

- **Market 8 - call origination:** The relevant product market consists of the conveyance of all types of calls (e.g. voice calls to fixed and mobile networks and to abroad, calls to Internet service providers and calls to value-added services) from an end user who is connected to a fixed electronic communications network

and services), as adapted by Protocol 1 thereto and by the sectoral adaptations contained in Annex XI to that Agreement. The Recommendation was adopted by Decision No 688/08/COL.

to the lowest point for the exchange of interconnection traffic. For calls taking place solely within a single provider's network, the originating part of the call within the interconnection area is included in the relevant market. The market definition includes traffic based on Voice over the Internet Protocol (VoIP) that uses telephone numbers. PTA defines the geographic scope of the relevant market as the entire country;

- **Market 9 – call termination:** The relevant market consists of the conveyance of voice calls from the lowest point for the exchange of interconnection traffic to an end user who is connected to a fixed electronic communications network. For calls taking place solely within a single provider's network, the terminating part of the call within an interconnection area will be included in market 9. The market definition includes traffic based on VoIP that uses telephone numbers. PTA defines the geographical scope of the relevant market as corresponding to the geographical coverage of each individual provider's network;

- **Market 10 – transit:** The relevant market consists of the conveyance of calls from another network to a third network. On the basis of the circumstances and interconnection terms in Iceland (each network has only one interconnection area), PTA considers that transit services on a telephone network exist only when a call is conveyed from one network through a voice call network to another third party network. The market definition includes traffic based on VoIP that uses telephone numbers. PTA defines the geographic scope of the relevant market as the entire country.

In its conclusion regarding the relevant markets, PTA explicitly includes in the scope of the relevant markets the various services elements that are necessary for network interconnection and are offered at the wholesale level in relation to respectively origination, termination and transit services.

II.2 Assessment of significant market power ("SMP")

- **Market 8 - The market for call origination services:**

The criteria relied upon by PTA in its determination of significant market power are, *inter alia*, Síminn's high market share of above 70% in the relevant market (traffic volume and revenues), overall size, profitability and price developments, entry barriers, potential competition and innovation, provider behaviour, and conditions on the demand side. PTA has therefore looked at a number of criteria which, in the view of PTA, do not refute the presumption of significant market power based on Síminn's market share of above 50% over the time horizon of the review.[4]

Based on the above analysis, PTA designates Síminn as individually possessing significant market power in the wholesale market for fixed call origination services.

- **Market 9 - The market for call termination services:**

In assessing market power in the markets for call termination services as defined on the basis of individual provider's networks, PTA considers the following factors: market

[4] PTA finds Síminn's market share to be decreasing since 2004. In 2003 over 80% of all traffic minutes originated in the fixed network of Síminn. PTA recognises that Síminn is losing market share but does not expect that the company's market share will decrease below 50% within the time horizon of the current market review.

share, profitability and price trends, entry barriers and potential competition under consideration of the Calling Party Pays (CPP) principle, and demand side conditions, in particular any countervailing buying power.

In addition, PTA examines in detail the ability of providers other than Síminn to set and maintain termination prices independently of Síminn and at a level higher than that of Síminn's termination prices. Such ability, together with a market share of 100%[5] and absolute entry barriers on the termination markets indicate significant market power enjoyed by the alternative providers of call termination services.

In conclusion, PTA designates Síminn and Vodafone as having significant market power in the respective markets for call termination services.

- **Market 10 - The market for transit services:**

PTA considers the following factors in assessing whether or not to designate Síminn as a provider with significant market power: market share of 100% based on revenues, far greater number of transit customers, profitability and price developments, entry barriers, potential competition and innovation, bundling of product/product differentiation, vertical and horizontal integration, countervailing buying power.

Alternatively, PTA considers a broader market definition, under which traffic volumes yield market shares of over 60% for Síminn, which, in addition to the factors mentioned above, would lead PTA to confirm Síminn's significant market power position under this hypothetical market definition.

On the basis of the duopolistic character of the Icelandic market for transit services, PTA has examined whether the existing market conditions indicate that Síminn and Vodafone exercise joint dominance on the relevant market. PTA has analysed the main criteria that determine the existence of joint dominance, in particular looking into homogeneity of the services, comparable cost structure, market shares, maturity of the technology, entry barriers and lack of potential competition, countervailing buying power, links between the parties, retaliatory mechanisms and price competition. PTA has found that some characteristics could indicate joint dominance, but at the same time it has identified some other characteristics that indicate the opposite, especially the lack of homogeneity of the service, of similar market shares and of retaliatory mechanism. Therefore, PTA considers that the conditions in the relevant market do not indicate that Síminn and Vodafone act in concert, but rather that Síminn alone has significant market power.

PTA concludes that Síminn individually has significant market power in the market for transit services.

II.3 Regulatory remedies

PTA intends to impose on Síminn the following regulatory remedies in the **market for call origination services:**

- **Access/information** – an obligation to meet all reasonable requests for interconnection, an obligation to negotiate necessary agreements without undue delay and upon request to document time spent vis-à-vis contracting party, an

[5] Operators who provide termination services on their own network, defined as a separate market, have a market share of 100% on the so defined relevant market.

obligation to produce documentation and justification of denial of requests for access;

- **Non-discrimination** – an obligation to provide access as specified above on non-discriminatory terms;

- **Transparency** – an obligation to prepare and publish a reference offer and publication/notification of interconnection-related information;

- **Accounting separation** – an obligation to separate the accounting for wholesale fixed-line telephone operations, on the one hand, and retail fixed-line operations, on the other, from other activities;

- **Price controls and cost accounting** – an obligation to offer call origination in the fixed-line network at cost-oriented prices, including a suitable return on capital employed. In order to meet this obligation, Síminn is required to prepare, within six months following the publication of PTA's decision, a cost model for price calculation using historical costs as a reference. This cost model will be submitted to PTA. In determining the appropriate level for the cost orientation, PTA will also use the operations of a comparable, efficiently run service as a guideline. Until that assessment is completed, Síminn is obliged to offer call origination prices that do not exceed the current level (price cap). Based on the results of the cost analysis and on comparison with prices in other EEA States, PTA will assess, on an annual basis, whether it is more suitable to use the long-run incremental cost ("LRIC") method than to use the historical cost method to determine the company's price lists.

PTA intends to impose the following regulatory remedies in the **market for call termination services:**

On Síminn:

- **Access/information** – an obligation to meet all reasonable requests for interconnection and access to co-location, an obligation to negotiate necessary agreements without undue delay and upon request to document time spent vis-à-vis contracting party, an obligation to produce documentation and justification of denial of requests for access;

- **Transparency** – an obligation to prepare and publish a reference offer and publication/notification of interconnection-related information;

- **Non-discrimination** – an obligation to provide access as specified above on non-discriminatory terms;

- **Accounting separation** – an obligation of accounting separation;

- **Price controls and cost accounting** – an obligation to offer call termination in the fixed-line network at cost-oriented prices, including a suitable return on capital employed. In order to meet this obligation, Síminn is required to prepare, within six months following the publication of PTA's decision, a cost model for price calculation using historical costs as a reference. This cost model will be submitted to PTA. In determining the appropriate level for the cost orientation, PTA will also use the operations of a comparable, efficiently run service as a guideline. Until that assessment is completed, Síminn is obliged to offer call termination prices that do not exceed the current level (price cap). Based on the results of the cost analysis and on comparison with prices in other EEA States, PTA will assess, on an annual basis, whether it is more suitable to use the LRIC method than to use the historical cost method to determine the company's price lists.

On Vodafone:

- **Access/information** – an obligation to meet all reasonable requests for interconnection, an obligation to negotiate necessary agreements without undue delay, and an obligation to produce documentation and justification of denial of requests for access;

- **Non-discrimination** – an obligation to provide access as specified above on non-discriminatory terms;

- **Transparency** - publication of price list and other technical and accounting information;

- **Price control** – an obligation to offer call termination fair prices. These prices will be based on Síminn's price list, and may not be higher than Síminn's. Vodafone will have a four year adaptation period leading to symmetrical prices with Síminn. Four equal reductions will occur annually, conforming a four year glide path. The level of final price caps on Vodafone presented in the glide path may be revised depending on the outcome of the price calculation to be determined by Síminn within the next six months after publication of this decision by PTA, subject to PTA's approval. In the period from publication of the final PTA's decision until the first step in the glide path enters into force (see the table below), Vodafone is imposed an obligation to offer call termination prices that do not exceed the level specified in the decision (price cap).

	Day rate ISK/min	Evening/night/weekend rate ISK/min	Connection fee ISK/connection
Síminn's prices from publication of decision	0.44	0.26	0.68
Vodafone's prices from publication of decision	0.66	0.44	0.99
Vodafone's prices 1 years after publication of decision	0.61	0.40	0.91
Vodafone's prices 2 years after publication of decision	0.55	0.35	0.84
Vodafone's prices 3 years after publication of decision	0.50	0.31	0.76
Vodafone's prices 4 years after publication of decision	0.44	0.26	0.68

PTA intends to impose on Síminn the following regulatory remedies in **the market for transit services:**

- **Access/information** – an obligation to meet all reasonable requests for call transit, including related invoicing services (e.g. requests for cascade billing), if necessary: an obligation to negotiate necessary agreements without undue delay and upon request to document time spent vis-à-vis contracting party; an obligation to produce documentation and justification of denial of requests for access;

- **Non-discrimination** – an obligation to offer access as specified above on non-discriminatory terms

- **Transparency** – an obligation to prepare and publish a reference offer and publication/notification of interconnection-related information;

- **Accounting separation** – an obligation of accounting separation;

- **Price controls and cost accounting** – an obligation to offer call transit in the fixed-line network at cost-oriented prices, including a suitable return on capital employed. In order to meet this obligation, Síminn is required to prepare, within six months following the publication of PTA's decision, a cost model for price calculation using historical costs as a reference. This cost model will be submitted to PTA. In determining the appropriate level for the cost orientation, PTA will also use the operations of a comparable, efficiently run service as a guideline. Until that assessment is completed, Síminn is obliged to offer call transit prices that do not exceed the current level (price cap). Based on the results of the cost analysis and on comparison with prices in other EEA States, PTA will assess, on an annual basis, whether it is more suitable to use the LRIC method than to use the historical cost method to determine the company's price lists.

III COMMENTS

The Authority has examined the notification and has the following comments pursuant to Article 7(3) of the Framework Directive:

Reference to efficiently incurred costs

The Authority welcomes PTA's commitment to consider the principle of efficiently incurred costs in their implementation of the obligations to charge cost-oriented prices. In the case of termination rates, the Authority recommends PTA to draw guidance as to the concrete implementation of the principle of cost efficiency for instance in the works of the Commission and the European Regulators Group ("ERG") on the matter.

Follow-up on the price control and cost accounting obligations

The Authority invites PTA to inform it of the progress made on the cost accounting obligations imposed on the three relevant markets. The Authority reminds PTA of the need to notify any amendments to the obligations that would result from the cost accounting analysis that PTA intends to perform.

Price control obligations on the market for call termination

The objective of promoting competition in the provision of electronic communications networks and services is a pivotal aim of the regulatory framework.[6] The Authority has already stated that the NRAs' promotion of this objective should be limited to measures ensuring an efficient use of the entry assistance as well as a precise time horizon for its application.[7] The Authority has also made clear in its previous comments concerning termination rates, that these should be symmetrical.[8] Therefore, the Authority welcomes PTA's intention to bring termination rates in the markets under scrutiny to a symmetric efficient costs based level.

However, the Authority has some concerns regarding the justification for the length of the transition period of four years prior to the elimination of the asymmetry of termination rates. PTA refers to the ERG common position on termination rates (ERG CP),[9] in its considerations as to the appropriate duration of the reasonable period of time leading to symmetric termination rates. The ERG CP establishes a list of parameters against which the appropriate duration should be considered, namely taking into account the prevailing local circumstances.[10] The Authority acknowledges PTA's margin of discretion in determining the timeframe for a path of convergence towards symmetry, based on the principles set out in Article 8(4) of the Access Directive.[11] However, the Authority recalls that this margin has limits, namely in the necessity to restrict the duration of excessive termination rates to the period that is strictly justified. The Authority considers that PTA has not sufficiently presented in its analysis the application of the parameters provided in the ERG CP to the Icelandic case, resulting in its conclusion to establish the length of the adaptation period to four years.

Therefore, the Authority invites PTA to include in its final decision a more comprehensive analysis of the application to the Icelandic circumstances of the criteria leading to the determination of the four year adaptation period.

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[6] Article 8(2) of the Framework Directive.

[7] Authority's comments letters of 4 May 2007 and 3 November 2008 pursuant to Article 7(3) of Directive 2002/2l/EC on the Norwegian wholesale markets for voice call termination services on individual mobile networks. See also Commission's previous cases DE/2006/0421, AT/2006/0544, LV/2007/0574, FR/2007/0596 EE/2007/0598, BE/2006/0433, FR/2006/0461, FR/2007/0669 and ERG (07) 83, i.a. p. 5.

[8] Authority's comments letters of 3 November 2008 and 4 May 2007 pursuant to Article 7 (3) of Directive 2002/21/EC on the Norwegian wholesale markets for voice call termination services on individual mobile networks.

[9] ERG (07) 83 final 080312 Common Position on symmetry of fixed call termination rates and symmetry of mobile call termination rates, adopted by the ERG-Plenary on 28 February 2008.

[10] Such as the actual and forecasted level of competition in the fixed access retail market (in terms of actual number of alternative operators and their respective market shares), the date of market opening, the date when asymmetry was established by NRA and its impact on fixed voice markets fluidity, network technologies and topologies, network coverage and offered services, ERG CP p. 41.

[11] Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities, OJ L 108, 24.4.2002, p. 7.

IV FINAL REMARKS

Pursuant to Article 7(5) of the Framework Directive, PTA may adopt the resulting draft measure and, where it does so, shall communicate the final measure to the Authority.

The Authority's position on this particular notification is without prejudice to any position the Authority may take *vis-à-vis* other notified draft national measures.

Pursuant to point 12 of the Authority's Article 7 Recommendation[12], the Authority will publish this document on its eCOM Online Notification Registry. The Authority does not consider the information contained herein to be confidential. You are invited to inform the Authority within three working days following receipt of this letter whether you consider that, in accordance with EEA and national rules on confidentiality, this document contains confidential information which you request to be deleted prior to such publication. You should give reasons for any such request. The request should be submitted through the eCOM Registry or by facsimile to +32 22 86 18 00, for the attention of the eCOM Task Force.

Yours sincerely,

Hallgrímur Ásgeirsson
Director
Internal Market Affairs Directorate

Per Andreas Bjørgan
Director
Competition and State Aid Directorate

[12] EFTA Surveillance Authority Recommendation (No 193/04/COL) of 14 July 2004 on notifications, time limits and consultations provided for in Article 7 of Directive 2001/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (the "Article 7 Recommendation"), OJ L113/10 of 27.4.2006.