Brussels, 26 July 2013
Case No: 74047
Event No: 678479

Póst- og Fjarskiptastofnun
Sudurlandsbraut 4
108 Reykjavik
Iceland

For the attention of:
Mr Hrafnkell Gíslason, Director

Dear Mr Gíslason,

Subject: Case No 74047 – Remedies relating to the markets for wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location (market 4) and wholesale terminating segments of leased lines in Iceland (market 6)

Comments pursuant to Article 7(3) of Directive 2002/21/EC (Framework Directive)[1]

I. Procedure

On 26 June 2013, the EFTA Surveillance Authority ("the Authority") registered draft measures pursuant to Article 7 of the Framework Directive from the Icelandic national regulatory authority ("NRA"), *Póst- og Fjarskiptastofnun* ("the PTA"), concerning a review of the wholesale tariffs for copper local loops in Iceland. In particular, the PTA proposes amendments to the applicable tariffs in the markets for wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location[2] and wholesale terminating segments of leased lines.[3] The notifications became effective on the same day.

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[1] *Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services*, OJ L 108, 24.4.2002, p. 33 (as amended by Regulation (EC) No 717/2007, OJ L 171, 29.6.2007, p. 32 and Regulation (EC) No 544/2009, OJ L 167, 29.6.2009, p. 12), as referred to at point 5cl of Annex XI to the EEA Agreement and as adapted to the Agreement by Protocol 1 ("the Framework Directive").

[2] Corresponding to market 4 of the *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 (the Framework Directive), as adapted by Protocol I thereto and by the sectoral adaptations contained in Annex XI to that Agreement*; OJ C 156, 9.7.2009, p.18 ("the Authority's 2008 Recommendation").

[3] Corresponding to market 6 of the Authority's 2008 Recommendation.

Pursuant to Article 6 of the Framework Directive, the national consultation on the remedies relating to market 4 took place from 5 to 18 June 2013 and the national consultation on the remedies relating to market 6 took place from 14 to 21 June 2013.

A request for information was sent to the PTA[4] on 4 July 2013 and a response was received on 9 July 2013.

The period for consultation with the Authority and the NRAs in the EEA States under Article 7 of the Framework Directive expires on 26 July 2013.

II. Description of the draft measures

II.1. Background

The PTA previously notified the markets for wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location (market 4[5]) and wholesale terminating segments of leased lines (market 6[6]) in 2007.

In respect of market 4, the PTA defined the relevant market as wholesale unbundled access (including shared access) to metallic loops and sub-loops for the purpose of providing voice and broadband services. It excluded access to cable, fibre-optic and wireless networks from the relevant market at the time. The PTA found Míla ehf. ("Míla")[7] to have significant market power ("SMP") on the relevant market.

In respect of market 6, the PTA defined the relevant market in a technology-neutral manner, including both digital and analogue lines with all possible technology and transmission media/protocols. The definition thus includes traditional copper lines, as well as Ethernet connections and fibre-optic lines. Síminn hf. ("Síminn") and Míla were designated with SMP on that relevant market.[8]

As regards SMP obligations for market 4, Míla was subjected to wholesale obligations of access to copper local loops and related infrastructure including information and support systems, non-discrimination (as regards price and other conditions of access), transparency, accounting separation, price control (cost orientation) and cost accounting. As regards the price control, the cost-oriented tariff was to be sub-divided into a monthly basic price (for access to the lower frequency range of the local loop), monthly additional

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[4] In accordance with Article 5(2) of the Framework Directive.

[5] Formerly market 11 of EFTA Surveillance Authority Recommendation (Decision No. 194/04/COL) of 14 July 2004 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 ("the Authority's 2004 Recommendation"); see the Authority's comments letter of 10 December 2007 - Case No: 63207, Event No: 454493.

[6] Formerly market 13 of the Authority's 2004 Recommendation; see the Authority's comments letter of 26 March 2007 - Case No: 59834, Event No: 414592.

[7] Míla is a subsidiary of the incumbent electronic communications provider in Iceland, namely Skipti hf. See footnote 8 below.

[8] Síminn and Míla are both subsidiaries of the incumbent telecommunications provider in Iceland. Structural changes to the incumbent were approved in March 2007 whereby the new parent company, Skipti hf., was introduced and Síminn was split into three companies: Síminn hf. - the main operating company, Fasteignafélagið Jörfi ehf. - a real estate company, and Míla which owns and operates the national trunk and access networks in Iceland. Source: http://www.skipti.com/about-skipti/chronicle/. The currently notified updates to the market 6 remedies apply to Míla.

fees for shared access (for access to the upper frequency range of the local loop) and fees for related facilities (e.g. co-location and access to facilities related to copper local loops).[9]

On market 6, wholesale obligations were imposed on Síminn and Míla for access to leased lines on reasonable request, price control and cost accounting[10], non-discrimination, transparency (publication of reference offer), and accounting separation.

II.2. Regulatory remedies

a) Market for wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location (market 4)

In April 2013, Míla submitted a reviewed cost analysis for its copper local loops based on the operating year 2012[11] together with a request to the PTA to increase the wholesale tariffs for fully unbundled access to ISK 1437 per month, and to increase the basic price to ISK 1081 per month and the fee for shared access (to the upper frequency range) to ISK 357 per month.

Míla's cost analysis is based on the same calculation methodology as in the previous analysis, i.e. a fully allocated costing approach using historical costs ("FAC HC").

However, the following modifications to the cost calculation were proposed:

- instead of basing the calculation on prices as of mid-2012, the investments and operating costs were calculated forward to March 2013; and
- instead of basing the calculation on the average number of lines for the year 2012, the number of lines was based on the status as of December 2012.

According to Míla, the rationale for these changes was that the previous method did not allow the company to achieve its planned returns due to increasing operating costs. While the present costing methodology for calculating access tariffs for copper local loops in Iceland is based on FAC HC[12], Míla considers that an appropriate development of the cost model could be to use current price levels as a reference instead of historical costs.

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[9] The proposed price control consisted of an obligation to determine a cost-oriented access tariff based on historical costs and including a reasonable return on investment. All changes to the access tariff were to be notified to the PTA for prior approval. Pursuant to PTA Decision No 13/2009, the basic price for the local loop was ISK 916 (lower frequency range) and for shared access ISK 302 (upper frequency range), resulting in a total price for fully unbundled access of ISK 1218 coming into effect on 1 September 2009. Following a ruling of the Appellate Committee from January 2010, these prices were revised to ISK 1223 for fully unbundled access, ISK 920 for the basic price and ISK 303 for shared access with effect from 1 March 2010. In August 2011, Míla submitted a reviewed cost analysis for its copper local loops, connection charges and access to distribution frames resulting in PTA Decision No 30/2011 with prices of ISK 1276 for fully unbundled access, ISK 959 for the basic price and ISK 317 for shared access.

[10] The PTA directed Síminn and Míla to prepare a cost model for calculation of the wholesale prices of terminating segments of leased lines based on historical costs within one year from the date of the decision. Pursuant to PTA Decision No 34/2011, a new wholesale tariff was determined in accordance with Míla's cost analysis.

[11] This cost analysis does not cover Míla's fibre-optic network as that service is not subject to obligations in market 4.

[12] The PTA notes that it has also reserved the possibility of taking into account comparable efficiently-run services and evaluating whether a LRIC (Long Run Incremental Cost) methodology might be a more appropriate reference than historical costs.

In terms of cost calculation, the PTA broadly accepts Míla's analysis of: (i) the pre-tax weighted average cost of capital of 8% for 2012, (ii) operational costs for the year 2012, (iii) costs from funds bound in working capital, and (iv) charges for activation of the local loops and access to distribution frames. As regards 2012 investment costs, the PTA's assessment is also broadly consistent with Míla's analysis[13] which includes a notable increase in the cost of copper lines (compared to 2011 levels) mainly due to upgrading street cabinets for the introduction of VDSL.[14] The PTA does not, however, accept the proposed projection of operational and investment costs to March 2013, noting that it is not possible to presume in advance that the costs would follow general price levels. In relation to the number of leased copper lines, which has experienced a decline over the period in question, the PTA plans to take into account the latest available figures (as of April 2013) to account for this steady decrease.[15]

On the basis of the above, the PTA proposes, having also taken account of applicable prices in other EEA markets at the end of 2012 and its previous cost analyses (2002-2011), to set monthly access fees of ISK 1042 for the basic price, ISK 344 for shared access (to the upper frequency range), and ISK 1386 for fully unbundled access to the local loop (i.e. an 8.6% increase from the current tariff for full unbundling) which is due to come into effect on 1 August 2013.

b) Market for wholesale terminating segments of leased lines (market 6)

Míla submitted calculations for new wholesale tariffs for terminating segments of leased lines on 12 June 2013. According to Míla, the purpose of the proposed increase (in the current tariffs which were in place since 1 March 2012) was to incorporate the above-specified increase in the price of wholesale access to copper local loops.[16] As a result, Míla concluded that wholesale tariffs should increase by approx. 8.5%-8.7% for analogue leased lines, by approx. 3.2%-5.8% for digital leased lines, and by approx. 1.9%-4.5% for Ethernet leased lines (via the copper network).

The PTA does not plan to contest Míla's conclusions on these proposed tariff increases.

III. Comments

The Authority has examined the notified draft measures and has the following comments:

The need to conduct new market reviews for markets 4 and 6

Pursuant to Article 8(4) of the Access Directive[17], obligations shall be based on the nature of the problem identified and be proportionate and justified in the

[13] The PTA's analysis yielded total investment costs of just over ISK 0.1 billion lower than Míla's estimation, mainly due to differing periods of depreciation. It was therefore proposed to use the PTA's slightly lower value for 2012 investment costs.

[14] In its response to the request for information, the PTA noted that, taking account of current VDSL (Very High Speed Digital Subscriber Line) roll-out plans, costs could be expected to be similar in 2013 but would decrease after that.

[15] While the number of line equivalents was 177,566 at the end of December 2012, the PTA proposes to take into account the number of line equivalents at the end of April 2013, which was 175,425.

[16] This is because the price of the local loop is an input into Míla's cost model for terminating segments of leased lines.

[17] *Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities*, OJ L 108, 24.4.2002, p. 7, as referred to at point 5cj of Annex XI to the EEA Agreement and as adapted to the Agreement by Protocol 1 ("the Access Directive").

light of the objectives laid down in Article 8 of the Framework Directive. Furthermore, according to Article 16(2) of the Framework Directive, NRAs shall decide whether to impose, maintain, amend or withdraw obligations on undertakings on the basis of a market analysis.

In that respect, the Authority notes that the PTA carried out the previous market reviews for markets 4 and 6 in 2007/2008. While the PTA has noted its plan to notify the updated reviews of markets 4 and 6 to the Authority later in the Autumn of 2013, the Authority recalls the need for timely, targeted, and proportionate regulation based on the nature of the competition problems identified in the course of an updated market analysis. The Authority thus urges the PTA to conclude its market reviews for markets 4 and 6 without further delay.

Methodology for calculating wholesale access tariffs for copper local loops in Iceland and forthcoming guidance on costing methodologies

While the PTA concluded that an FAC HC methodology was appropriate to determine access tariffs in the present draft measure, the Authority notes that the PTA had also reserved the possibility of taking into account comparable efficiently-run services and a LRIC methodology to determine the wholesale tariffs in question. However, having benchmarked the FAC HC outcome in the present case against other EEA countries and against previous cost analyses in Iceland, the PTA considers that the FAC HC results are, in this instance, sufficiently reflective of an efficiently-operated network. In its response to the Authority's request for information, the PTA also justifies the use of FAC HC on the grounds that it is an established method, known to the parties in Iceland. The PTA also points to the limited resources which necessitate proportionality considerations associated with implementing any alternative methodology.

When setting regulated prices in line with the EEA regulatory framework for electronic communications, the Authority recalls that NRAs should seek *inter alia* to: (i) promote efficiency and sustainable competition[18], (ii) ensure that end users enjoy maximum benefits[19], and (iii) encourage efficient investment in infrastructure.[20] Promoting regulatory stability, consistency and proportionality are further guiding principles of the regulatory framework.[21] The Authority thus recognises the challenges facing NRAs in balancing a wide variety of regulatory policies and principles when setting regulated access tariffs.

In the present draft measure, the Authority notes the significant reliance on Míla's own costing data as a consequence of using the FAC HC approach with potential implications for its capacity to mimic a competitive market outcome and provide appropriate build-or-buy signals. At the same time, however, the

[18] In line with Recital 20 of the Access Directive and pursuant to Article 8 (2)(b) of the Framework Directive.

[19] In line with Recital 20 of the Access Directive and pursuant to Article 8 (2)(a) of the Framework Directive.

[20] Pursuant to Article 8 (2)(c) of the Framework Directive.

[21] See, for example, paragraph 118 of *EFTA Surveillance Authority Guidelines of 14 July 2004 on market analysis and the assessment of significant market power under the regulatory framework for electronic communications networks and services*, referred to in Annex XI of the Agreement on the European Economic Area, OJ C 101, 27.4.2006, p.1.

Authority is mindful of the supplementary costing tools available to the PTA, as well as of the importance of regulatory consistency in the tariff-setting approach. The Authority nonetheless urges the PTA in its forthcoming updated reviews of markets 4 and 6 to ensure clarity on precisely how the chosen cost methodology (supplemented by other price-control methods, where appropriate, and with a clear elaboration of the relevant steps in each case) may publication. The PTA should provide reasons for any such request.

Yours sincerely,

Bernhard Zaglmayer

Acting Director

Internal Market Affairs Directorate

Per Andreas Bjørgan

Director

Competition and State Aid Directorate

[24] The request should be submitted through the eCOM Registry or by e-mail to Ecom@eftasurv.int, marked for the attention of the eCOM Task Force.