Appendix II

POST AND TELECOM
ADMINISTRATION
IN ICELAND

Conclusions from PTA consultation on wholesale tariff for call origination and termination in public telephone networks provided at a fixed location (Markets 2 and 3)

15 June 2015

POST AND TELECOM ADMINISTRATION IN ICELAND

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1. Introduction

This document contains the comments received as a result of the Post and Telecom Administration (PTA) consultation on the Preliminary Draft Decision with respect to the wholesale tariff for call origination and termination in public telephone networks provided at a fixed location. The initial draft was submitted to stakeholders for consultation on the Administration's website on 31 March 2015 and the consultation ended last 5 May.

Comments were received from 365 miðlar ehf. (365) and Síminn hf. (Síminn).

Endeavours have been made to identify all significant comments and to answer them. At the end of each comment there is a short summary of the position of the PTA.

2. Period of validity of the new tariff

365 refers to the Draft Decision where it is stated that the coming into force of the new tariff shall be postponed until 1 January 2016.

365 is pleased with the planned changes. In the light of the fact that the previously specified changes will not take place until after a period of 6 months, 365 draws particular attention to the fact that a significantly long period of time has already passed since the above specified ideas were first presented. 365 considers that the period of notice currently allowed for is too long and that there is no reason to give the electronic communications companies in question such a generous period of notice. 365 also considers that there has long been a need for a reduction of the tariff in question.

Although 365 considers there to be no need to specifically object to the above specified period of notice, there is however a pressing need for PTA plans not to be subject to further delays and that it should be established that the price changes will come into force no later than on 1 January next year.

The position of the PTA

The 365 comments support the planned PTA Decision. The Draft Decision expounds the reasons the Decision on a new wholesale tariff for origination and termination of telephone calls in public telephone networks provided at a fixed location based on benchmarking, has been delayed beyond what was stated in the PTA Decision no. 36/2012. As stated in Section 1.2 in the Draft Decision, the most significant reasons were external factors.

With respect to the 365 comment to the effect that an excessively long period of notice is granted to electronic communications companies to reduce the charges in question, that is to say until the next turn of the year, the PTA points out that such price changes normally come into force at the turn of the year. The PTA has however in exceptional cases prescribed that such price changes shall take place in the middle of a year. It is clear that a final decision in the case here under discussion will not come to light before the beginning of July, as it is not seen that formal consultation with ESA will begin before the middle of June. In the opinion of the PTA, it is an absolute minimum to provide electronic communications companies with a 2-3 month notice for such price reduction after the publication of the Decision. As previously stated, the PTA considers it normal that such price changes should only take place at the beginning of the year or in exceptional cases in the middle of a year.

The PTA can agree with 365 that the notice granted is quite generous in the light of the fact that some time has now passed since it was decided to apply benchmarking. The information used by the PTA in benchmarking has, at least in part, been available for quite some time. It is however not possible to expect that the smaller electronic communications company will have had the wherewithal to closely monitor developments in Europe. The PTA plans not to delay the coming into force beyond the coming turn of the year.

3. Siminn performance at wholesale level

Síminn points out that almost all factors relating to wholesale of fixed line telephony are decided by the PTA. Returns at wholesale level will become negative with a reduction of origination charges and withdrawal of connection charges.

One must take into account whether companies in the states in question are authorised to collect other charges. Siminn points out that the PTA rejected that Siminn should be authorised to impose an annual charge for SB-CPS service.

Siminn considers that the planned decision to reduce charges for call origination and to withdraw the connection charge, which would lead to Siminn returns in wholesale of fixed line telephony becoming negative, given the current circumstances, lacks a basis in law. Siminn draws attention to the fact that this represents a 33% reduction in price of a three-minute telephone call. Siminn notes that the company's costs have not dropped by 33% during the same period which means that it is clear that the planned Decision breaches the principle of proportionality of the Administrative Procedures Act.

In addition to this Siminn requests that the methodology for cost analysis on Market 1 be reviewed in the light of the planned changes on Markets 2 and 3. At the very least it should be assured that Siminn wholesale of fixed line telephony is operated in such a manner that the service is profitable.

The position of the PTA

The PTA Decision no. 36/2012 decided the methodology now applied by the PTA for deciding price for call origination.

The Decision contained a precise description of the methodology that should be used when making the benchmarking. PTA finds it difficult to see how the cost incurred by Siminn could be taken into account in the benchmark. If Siminn's cost should be taken into account that would involve an analysis of Siminn's cost. However, in PTA Decision no. 36/2012 it was decided to abandon that methodology and use instead benchmarking when deciding the price for call origination.

The PTA Decision no. 36/2012 was neither appealed by Siminn nor by other electronic communications companies and thus stands as such. According to Paragraph 4 Article 32 of the Electronic Communications Act no. 81/2003 the PTA can when calculating costs, use as a reference the operation of an analogous service that is considered efficiently run. It can also take into account tariffs in comparable competition markets and it may use cost analysis methodologies that are not related to methodologies employed by the electronic communications company. Siminn assertion that the PTA lacks the legal basis to decide charges for call origination on the basis of benchmarking which was conducted in the manner prescribed in the PTA Decision no. 36/2002, is therefore unfounded.

The PTA is thus implementing with this Draft Decision, the Administration's Decision from 2012 and Siminn has had the opportunity to object to that Decision and furthermore, the company has been granted a generous notice to adapt to changed operations. Siminn assertion that the Administration is breaching the principle of proportionality of the Administrative Procedures Act is thus not justifiable. The PTA is obliged to implement the Administration Decision no. 36/2012 and with this Draft Decision, the PTA is fulfilling its obligations to all parties to this market. It should also be noted that the PTA plans to commence a new analysis of Markets 1-3 in the autumn and one can expect that this work will be completed with a Decision early next year. Siminn will then of course have the opportunity to make comments on the structure of price obligations that will be proposed.

In PTA decision no. 36/2012, Appendix A, Section 7.6.1.5 "Obligation for price control", the following is stated:

"The PTA considers that the prices for origination should relate to costs incurred in an efficiently designed electronic communications network and that, for this reason, the prices should be symmetrical in all companies. When analysing costs for call origination the PTA considers it appropriate to use the Long Run Incremental Cost methodology[1]*, that is to say the bottom-up LRIC model (BU-LRIC)*[2]*. One can compare the bottom-up model with the top-down model for adjustments. Costs in an efficiently operated network should be used and should include the most efficient technological solutions on offer during the period of validity of the Decision. This means that one should allow for next generation networks (NGN) in the core network.*

The following is stated later in that section:

"The PTA considers that because of the high cost of implementing the BU-LRIC cost model it is not appropriate at this point in time to adopt such a methodology on this market in this country. This could entail unnecessarily high costs for the PTA and for the relevant electronic communications companies. The Administration is very small in a European context and for this reason its budget is much more limited than is normally the case. Experience in the EEA had shown that the cost of making a BU-LRIC model was in the order of ISK tens of millions for each model and for each update. It was not considered right at this stage to make this requirement as the increase in cost would in all likelihood be eventually borne by consumers in the form of higher rates. Instead of this, the PTA plans to prescribe <u>the use of benchmarking, which is based on BU-LRIC cost prices, when deciding call origination prices.</u>

According to this, costs shall be used as incurred in an efficiently operated electronic communications network and if the Siminn public telephone network provided at a fixed location is not efficiently structured then it is possible that the costs of its operation could be greater than costs in such networks that are based on the most efficient technological solutions.

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[1] Long-Run Incremental Cost, LRIC, that is to say costs either added or saved by using the specific service or operation are added or deducted on the grounds that all costs are variable.

[2] One speaks of a "bottom-up" LRIC model (BU-LRIC) in the case of a cost model for calculating the price of service on the basis of costs incurred in an efficiently designed electronic communications network in the relevant electronic communications market.

In the PTA benchmarking the results from BU-LRIC models[3] were used which were based on an efficiently designed public telephone network provided at a fixed location where the most efficient technological solutions available are used. It is not expected that electronic communications companies with a dominant market position will recover costs resulting from inefficiencies in their network systems as such a situation would not be conducive to efficient investments in the electronic communications market. With the considerations of proportionality in mind, the PTA did not take results from pure BU-LRIC models[4] into account when calculating rates for call origination as such models are rather intended to calculate termination rates. Two states have used the pure BU-LRIC model to decide rates for call origination in public telephone networks provided at a fixed locations but the PTA decided not to include them in the benchmarking.

The European electronic communications regulatory framework allows for only costs incurred in an efficiently designed electronic communications network being recovered by prices decided by regulatory bodies.

Siminn asserts that the Siminn returns from wholesale fixed line telephony will be negative subsequent to the reduction of prices for call origination. The Siminn reasoning is that the company's costs have not fallen to the same extent as allowed for in the planned reduction of charges for call origination. Siminn has however not submitted further information to demonstrate the veracity of its assertions on negative performance at wholesale level. The intended conclusion from the benchmarking shows that current Siminn prices are higher than the benchmark prices that were decided on the basis of efficiently designed electronic communications networks. Current prices were on the other hand calculated using Siminn’s cost model where the cost base was historical cost (HCA) and all costs were allocated (FAC) to the service in question.

With respect to the Siminn observation on interaction between cost analysis on Market 1 and pricing on Markets 2 and 3, it should be noted that pricing on Market 1 is based on an obligation for price control pursuant to PTA Decision no. 8/2013 on the designation of a company with significant market power and on the imposition of obligations on the retail market for access to the public telephone network provided at a fixed location for residential and non-residential customers. In the review of market analysis of Market 1, 2 and 3 which commences in the coming autumn and which is expected to be completed in 2016, the PTA will have the Siminn observations in mind, should the obligation for price control be maintained. During the processing of that case, Siminn is of course free to reiterate and further argue its views on this issue.

[3] The comparison used conclusions from bottom-up LRIC, LRAIC, LRIC+ and LRAIC+ models.
[4] In the pure BU-LRIC models, only avoidable costs are taken into consideration and these models do not allow for full participation in joint costs.

4. Withdrawal of connection charge

Siminn objects to the PTA plan to withdraw connection charges. In the opinion of Siminn, the PTA arguments for withdrawing connecting charges are inadequate. The sole fact that other companies abroad do not impose such a charge is in the opinion of Siminn not an adequate argument, as the reason for interconnection charges not being imposed abroad has not been investigated.

The position of the PTA

The PTA considers that by discontinuing connection charges, the tariff will be simpler and more transparent.

The benchmarking provides a conclusion which is a price per minute without connection charge as the comparison countries used in the benchmarking almost all solely collect a charge per minute. In the comparison countries used in the benchmarking for the price of call origination, there is no country that has a connection charge. In the comparison countries used in benchmarking of termination charges there is one state of 15 that uses a connection charge and in that instance the average price per minute is calculated on the basis of a three-minute telephone call.

There are no cost related arguments for maintaining connection charges. It is possible that the PTA could have calculated a connection charge and charge per minute that would return the same average minute charge for a three-minute telephone call as the benchmarking did. Had the PTA chosen the path of maintaining connection charges, then the connection charge would have been lower than the existing connecting charge and the charge per minute would also have been lower than that proposed by the Administration in this Draft Decision. The PTA cannot see that such an arrangement would have been an improvement as the average price for a telephone call[5] would be the same and the PTA considers that the arrangement would only complicate the tariff.

[5] The average call length is 3 minutes according PTA latest statistical information.

5. The impact of special circumstances in this country on the price for call origination

Siminn points out that the countries used by the PTA are not comparable with Iceland. In the case of Siminn, users are significantly fewer than in other EEA countries, whereas Iceland is on the contrary significantly larger than many states within the EEA. It is therefore perfectly clear that economy of scale does not exist to the same degree as for example in Germany and Italy, which are among the comparison countries.

Siminn submitted the following table in support of its view:

Country	Population	Size	Inhabitants/km^2
Iceland	325,671	103,001	3.2
Denmark	5,655,750	42,916	131.8
Italy	60,782,668	301,338	201.7
Croatia	4,284,889	56,594	75.7
Malta	446,547	316	1,413
Norway	5,136,700	385,178	13.3
Slovakia	5,415,949	49,035	110.5
Sweden	9,716,962	449,964	21.6
Czech Republic	10,513,209	78,866	133.3
Germany	80,716,000	357,168	226

Siminn draws attention to the fact that the state most comparable to Iceland is Norway, which has however more than four times as many inhabitants per km^2 than Iceland. The country closest to Iceland in size is the Czech Republic, which has 133 inhabitants per km$^{2.}$ In the Czech Republic the origination charge is nevertheless, ISK 1.73. Siminn considers that one has to take into account the size of a country and number of inhabitants as this has an impact on economy of scale.

The position of the PTA

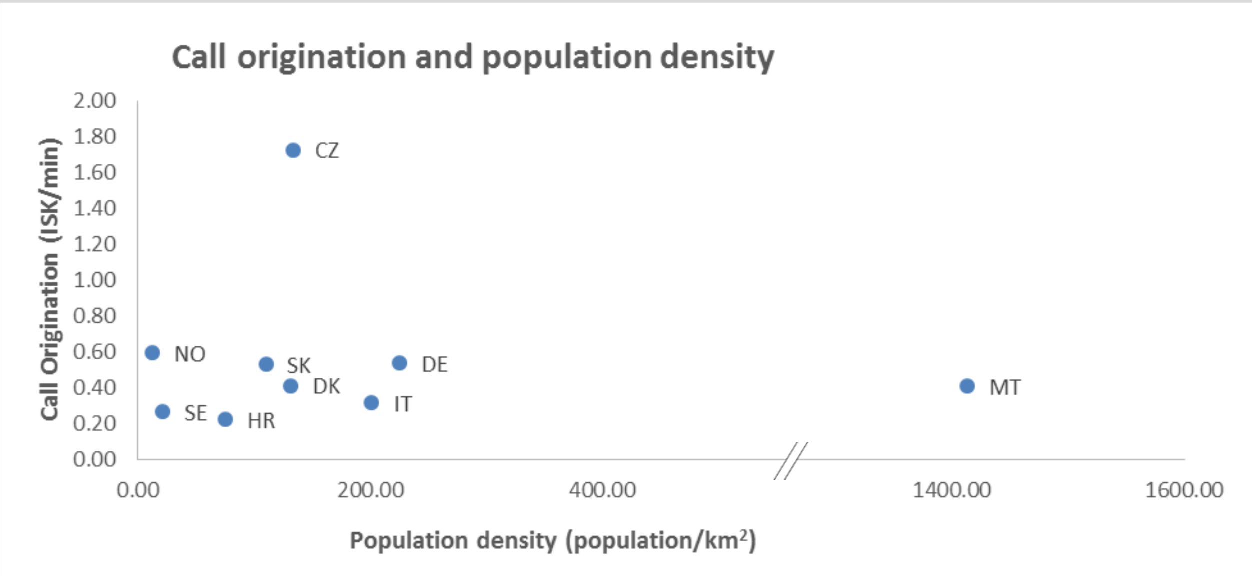
As mentioned here above the PTA Decision no. 36/2012 decided the methodology now applied by the PTA for deciding price for call origination.

The Decision contained a precise description of the methodology that should be used when making the benchmarking and it was not indicated in that description that the states should be selected on the basis of their population density.

The table below shows information on population density and price for call origination in the countries covered by the benchmarking.

Country name	Size in km²	Population	Inhabitants/km²	Origination ISK/minute
Denmark	42,916	5,655,750	131.79	0.41
Italy	301,338	60,782,668	201.71	0.32
Croatia	56,594	4,284,889	75.71	0.22
Malta	316	446,547	1413.12	0.41
Norway	385,178	5,136,700	13.34	0.59
Slovakia	49,035	5,415,949	110.45	0.53
Sweden	450,295	9,760,142	21.67	0.27
Czech Republic	78,866	10,538,275	133.62	1.73
Germany	357,168	80,716,000	225.99	0.54

One can see from this information that there is nothing to indicate that the price per minute for call origination is dependent on population density. One can see this more clearly in the figure below.



Apart from the Czech Republic, the charges are in the range of 0.2-0.6 ISK/minute independent of population density. The Czech Republic has higher charges, but it cannot be seen that this results from population density as there are five states that have both lower population density and lower rates per minute.

The same can be said if one examines the number of inhabitants where it cannot be seen that rates per minute decrease with number of inhabitants as the systems are scalable according to number of users. In addition to this, a country's area does not tell the whole story as in Iceland only 6% of inhabitants live outside urban areas. The largest part of Iceland is uninhabited, which means that this service is only being offered in a very small part of the 103,001 km^2 covered by the country.

There are various factors which can impact costs of electronic communications companies for provision of the service in question. The PTA considers there to be no arguments for taking one factor that could possibly have an impact on this cost and deciding on the basis of that factor another price for call origination than returned by the benchmarking. Such an approach would not be in line with PTA Decision no. 36/2012, where it is clearly stated that the price for call origination should be decided by benchmarking and where it is also prescribed how this benchmarking should be implemented. As previously stated, Siminn made no objections at that time to this methodology being used when deciding maximum prices.

6. Separation of accountancy

Siminn points out that in the planned PTA Decision on Market 7, obligations for separation of accountancy were withdrawn where there was benchmarking with comparison countries. Siminn considers it normal that the obligation for separation of accountancy on Markets 2 and 3 should also be withdrawn accordingly.

The position of the PTA

The PTA will examine this in the next review of market analysis of Markets 2 and 3 in the coming winter. The PTA points out that Siminn cannot expect that the company's costs on these markets should be taken into account while at the same time withdrawing the obligation for separation of accountancy.