Appendix B

PÓST- OG FJARSKIPTASTOFNUN

Conclusions from PTA consultation on preliminary draft of analysis of wholesale market for the call termination in individual mobile phone networks

(Market 7)

23 June 2015

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1 Introduction

This document contains comments received as a result of the Post and Telecommunications Administration (PTA) consultation on the wholesale market for termination of calls in individual mobile phone networks (Market 7) and the PTA answer to them. The initial draft was submitted to stakeholders for consultation on the Administration's website on 1 April 2015 which ended last 18 May.

The following parties submitted comments on the Preliminary Draft.

- The Competition Authority - hereafter named CA
- Siminn hf. -Hereafter named Siminn

Comments are categorised by subject, sections and paragraphs. 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 General comments

The Competition Authority stated that it restricted its comments on the PTA Preliminary Draft related to a definition of the relevant service and goods markets and to the geographical markets and to those issues that one could assume would influence assessment of company market power on individual markets. In the Draft, the market in question was defined in accordance with the role of the PTA. The Competition Authority made no comments on the part of the Draft that it examined and considered that the analysis was well made and that it served its objectives. All measures taken by the PTA that had the objective of or were conducive to preventing or tempering potential barriers to competition on the defined market, were positive in the opinion of the Competition Authority. This applied inter alia to the imposition of obligations as described in the PTA Draft, without the Competition Authority taking a position on what the termination charge should be.

It is however appropriate to state that the Competition Authority has the role of exercising the provisions of competition legislation, inter alia on the electronic communications market. The conclusion reached by the Authority on definitions of markets and of the positions of companies is decided by events in each individual case. In the light of this the Competition Authority would clearly not be bound by the methodology and the opinions expressed in the PTA Draft in question if in the future, it were to deal with cases related to the markets in question. The same applied to the methodology used to assess whether pricing of a specific service at a specific point in time was compatible with the provisions of the Competition Act.

The position of the PTA

The above specified observations strengthen the planned PTA Decision with respect to definition of service markets, geographic market and on the designation of undertakings with significant market power. With respect to the planned obligations, the Competition Authority notes that all measures taken by the PTA that had the objective of or were conducive to preventing or tempering potential barriers to competition on the defined market, were positive in the opinion of the Competition Authority. In the opinion of the PTA, the PTA obligations including the obligation for price control will have precisely this effect.

3 Analysis of the relevant market - Market share

Siminn made objections to the PTA calculation of shares in the retail market for mobile phone services. The PTA had not defined the market, but had rather seemed to use all income for service through the mobile phone system with the exception of call termination revenue. There seemed to be no distinction made between the wholesale market, the market for mobile phone services on the retail market, the market for data transfer through Internet dongles in the mobile phone system etc. Misleading or imprecise discussion can have a more negative impact than no discussion at all. If PTA did not define the relevant retail market in an adequate manner and directly requested information from electronic communications undertakings on revenue from the relevant markets, then Siminn considered it more appropriate that the PTA drop the discussion on market share in the retail market. In any event it was better to drop the discussion than to define the market wrongly. Reference was then made to Article

10 of the Administrative Procedures Act on the rule of investigation and to the fact that cases should be adequately investigated.

<u>The position of the PTA</u>
The information in question on retail share is published for the purpose of shedding light on the overall scope of companies on the mobile phone market and to show their relative positions. The same information has been published in prior analyses for the same purpose without comment from parties to the market. Retail revenue or share, whether solely for call minutes or for all mobile phone services, i.e. voice, SMS and data transfer, are not criteria for PTA Decisions on the relevant market and have no material impact on the conclusion of an analysis, as each company has a monopoly position in call termination in its own mobile phone network. The PTA will update statistical information in the analysis with the newest information, i.e. as of the end of 2014 instead of half of the year 2014 as was published in the Preliminary Draft.

4 Obligation for price control

Siminn drew PTA attention to conditions for authorisation to impose obligations for price control. The following is stated in Article 32 of the Electronic Communications Act:

"Where a market analysis indicates that a lack of effective competition means that an electronic communications undertaking with significant market power is demanding excessively high prices or that the difference between wholesale and retail prices is abnormally little, PTA may impose obligations on the electronic communications undertaking for cost orientation of prices and obligations concerning cost accounting systems, for the provision of specific types of interconnection or access. Consideration shall be shown for investments made by the electronic communications undertaking and for a reasonable rate of return on capital employed, taking into account the risks involved.

One could also draw attention to discussion in the explanatory text to the bill on electronic communications legislation where the following is stated:

"Where market analysis has led to the conclusion that a lack of competition leads to an electronic communications undertaking demanding excessively high charges or to an abnormally small difference between wholesale and retail prices, the Post and Telecom Administration can impose various obligations related to pricing on the company."

According to the above there would be several conditions that would need to be fulfilled for there to be authorisation to impose an obligation for price control. In the first case that there was no active competition and in the second case that this led to higher charges being demanded or to the difference between wholesale and retail prices being too small. The latter issue had received no attention in the PTS analysis, which means that the PTA had not adequately argued or investigated whether it was authorised to apply Article 32 of the Electronic Communications Act.

Siminn also wish to draw attention to the fact that the PTA benchmarking methodology had no appropriate legal basis. Recommendations from ESA or the EU Commission notwithstanding, all burdensome decisions must have a clear legal basis in Icelandic law, see for example the ruling of the Appellate Committee for Electronic Communications and Postal Affairs no. 4/2014 which drew clear lines to the effect that the PTA decisions needed to have a clear basis in law. The comparison methodology proposed by the PTA lacked legal authorisation. When calculating costs of an electronic communications undertaking, the PTA could use the operation of analogous service that is considered efficiently run, take into account tariffs in analogous competition markets and use cost analysis methodologies that are not related to methodologies employed by the electronic communications undertaking, see Paragraph 4 of Article 32.

Siminn therefore challenged the PTA to adapt the analysis and the planned Decision taking into account the legal authorisation on which they were grounded. The PTA was not authorised to decide price for an electronic communications undertaking without taking costs into consideration. Siminn wished nevertheless to note that the company was perhaps not averse to using benchmarking instead of imposing an obligation for a detailed and burdensome cost analysis. Legal authorisation for such a methodology was lacking when the conclusion led to the PTA totally deciding pricing for an electronic communications undertaking without taking into consideration the cost of analogous service on a comparable market. One hardly needed to discuss the fact that most EU States were not considered to be comparable competitive markets in comparison with Iceland and for obvious reasons, companies like Deutsche Telekom, Telefonica and TeliaSonera could not be compared with any company in Iceland.

The position of the PTA

In the opinion of the PTA, the legal basis for benchmarking is clear. In Paragraph 4 of Article 32 of the Electronic Communications Act it is clearly stated that the PTA is authorised to take into account tariffs on comparable competitive markets when deciding prices. This authorisation for the PTA is also confirmed in Paragraph 2 of Article 12 of Regulation no. 564/2011 on accounting and cost analysis in the operations of electronic communications undertakings.

In the Siminn observations it was stated that a number of conditions needed to be fulfilled for it to be possible to impose an obligation for cost control. In the first case that there was no active competition and in the second case that this led to higher charges being demanded or to the difference between wholesale and retail prices being too small. The latter issue had received no attention in the PTS analysis, which means that the PTA had not adequately argued or investigated whether it was authorised to apply Article 32 of the Electronic Communications Act.

The PTA indicates detailed discussion in Section 5.2.2 in Appendix A which deals with competition problems on the relevant market. There it is stated that mobile phone companies have a monopoly on call termination in their own networks and can therefore offer their service to a large extent without taking into account customers and competitors. This monopoly position enables them to demand higher termination prices than would be possible if there was pressure from competition. For this reason it is clear that active competition cannot exist on the relevant market in Iceland and it is equally clear that such circumstances would lead to higher charges being demanded by mobile phone companies if an obligation for price control were not in place. The market in question is in the EU Commission Recommendation from 2014, and in the ESA Recommendation from 2008 on the relevant market. All states in the EEA have come to the conclusion that competition is not active on this market. It is unequivocal pursuant to the legal provision in question that it suffices if the former condition is fulfilled, i.e. that too high a charge is demanded. This means that one does not need to make a separate assessment of the latter condition, i.e. that there is an abnormally small difference between wholesale and retail prices. Given the above, the PTA was thus authorised to apply the provision in question in the case here under discussion.

It was also stated by Siminn that the PTA benchmarking methodology had no appropriate legal basis. Recommendations from ESA or the EU Commission notwithstanding, all burdensome decisions must have a clear legal basis in Icelandic law, see for example the ruling of the Appellate Committee for Electronic Communications and Postal Affairs no. 4/2014 which drew clear lines to the effect that PTA decisions needed to have a clear basis in law. The benchmarking methodology proposed by the PTA lacked legal authorisation.

The benchmarking methodology in question has a clear legal basis in Paragraph 4 of Article 32 of the Electronic Communications Act. This has been tested with the Appellate Committee for Electronic Communications and Postal Affairs. The PTA Decision currently in force on the relevant market is no. 3/2012 where it was prescribed that a maximum price for call termination in mobile phone networks should be decided using the benchmarking methodology. The PTA now intends to continue using the same methodology. IP-fjarskipti (then Tal and now 365) appealed the PTA Decision in question and considered inter alia that an obligation for price control should not be imposed on the company. The Decision in question was confirmed with the ruling of the Appellate Committee for Electronic Communications and Postal Affairs no. 2/2012. It was deemed by the Appellate Committee that there was no reason to refute the appealed Decision as it had neither been demonstrated that the PTA grounds lacked legal basis and nor that they had been contrary to fundamental principles of non-discrimination and proportionality.

With the above in mind, the Appellate Committee has already prescribed that the benchmarking methodology has an adequate basis in law. The Ruling of the Appellate Committee referred to by Siminn here above has on the other hand, no validity in this instance. In that case, the matter in dispute was PTA authority pursuant to Article 16 of the Act on Postal Services no. 19/2002. The Appellate Committee came to the conclusion that the legal provision in question only granted the PTA authorisation to endorse or reject the Íslandspóstur tariff within monopoly, but not to amend it. The Decision of the PTA no. 16/2014 was thus revoked. It is clear that there is no similarity between these cases. It was not clearly prescribed in the provision in question in the Act on Postal Services that the PTA could amend tariffs. It is however clearly prescribed in Paragraph 4 of Article 32 of the Electronic Communications Act that the PTA is authorised, when specific conditions have been fulfilled, to apply the benchmarking methodology to decide maximum prices for electronic communications undertakings that have been designated as having significant market power.

Finally Siminn stated that when calculating costs of an electronic communications undertaking, the PTA could take into account the operation of analogous service that is considered efficiently run, take tariffs in analogous competition markets into account and use cost analysis methodologies that were not related to methodologies employed by an electronic communications undertaking, see Paragraph 4 of Article 32 of the Electronic Communications Act. Siminn nevertheless noted that the company was perhaps not averse to using benchmarking instead of having a detailed and burdensome cost analysis obligation imposed on the company.

When implementing benchmarking, the PTA has taken into account the ESA Recommendation from 2011 on termination rates[1]. It is an accepted view in Icelandic law that recommendations from ESA should be followed unless special circumstances particularly require the contrary.

The PTA considers that markets for mobile phone termination in EEA States where undertakings with significant market power on the relevant market are subject to price control by the regulatory authorities, are comparable to the Icelandic market for mobile phone call termination. These markets are characterised by undertakings with significant market power operating on the markets and being subject to a harmonised regulatory framework.

In accordance with the objectives of the European Regulatory Framework, Recommendations and Guidelines from the EU Commission and from ESA, the development has been such that the BU-LRIC (Bottom-Up Long Incremental Cost)[2] model has gradually replaced the cost model based on historical costs. This means that the methodology is no longer that of calculating rates on the basis of costs of individual electronic communications undertakings, but rather that costs are calculated from an engineering model of an electronic communications network. Prices decided by the relevant NRA are thus not calculated directly from the costs of companies like Deutsche Telecom, Telefonica and TeliaSonera although consideration is given to local circumstances on each market, such as the number of subscribers.

On some markets this development in methodology has led to a reduction in rates which particularly applies to termination markets where the (pure) BU-LRIC model is now used more frequently in accordance with the Recommendations of the EU Commission and of ESA on this issue. It is thus not abnormal that the same development should take place here, i.e. that termination rates will also be reduced in this country. In this connection one can point out that retail prices on the Icelandic mobile phone market have not been particularly out of line in international comparison, which indicates that there is no particular reason to assume that mobile phone system costs per user are greater in this country than elsewhere in Europe.

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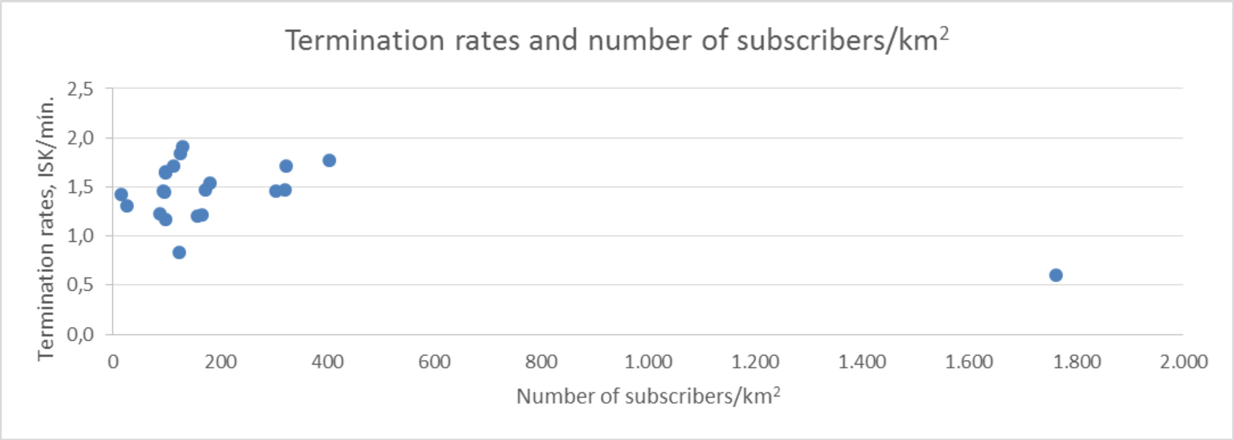
[1] EFTA Surveillance Authority Recommendation of 13 April 2011 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EFTA States.

[2] One speaks of the "bottom-up" model in the case of calculations made on the basis of an engineering model of electronic communications networks in the relevant electronic communications market. The model is based on a hypothetical network system which is efficiently designed and which uses the most efficient technical solutions on offer at any given time. The Long-Run Average Incremental Cost (LRIC), that is to say where costs which are either added or saved by using the specific service or operation are added or deducted on the grounds that all costs are variable.

Siminn considers that circumstances on the mobile phone market in this country are special and that it is not possible to use benchmarking to decide prices for mobile phone call termination. The PTA has examined if correspondence could be identified between termination rates on the mobile phone market calculated on the basis of pure BU-LRIC models and on the basis of number of subscribers or number of subscribers per km^2. It is not possible to see any correspondence between these factors and the termination rates.

The following figure shows termination rates of States on the basis of number of mobile phone subscribers[3] per km^2.

[table legend:
Title - Call termination rate and number of subscribers/km²
y-axis - Call termination rate ISK/min. x-axis - number of mobile phone subscribers/km²]

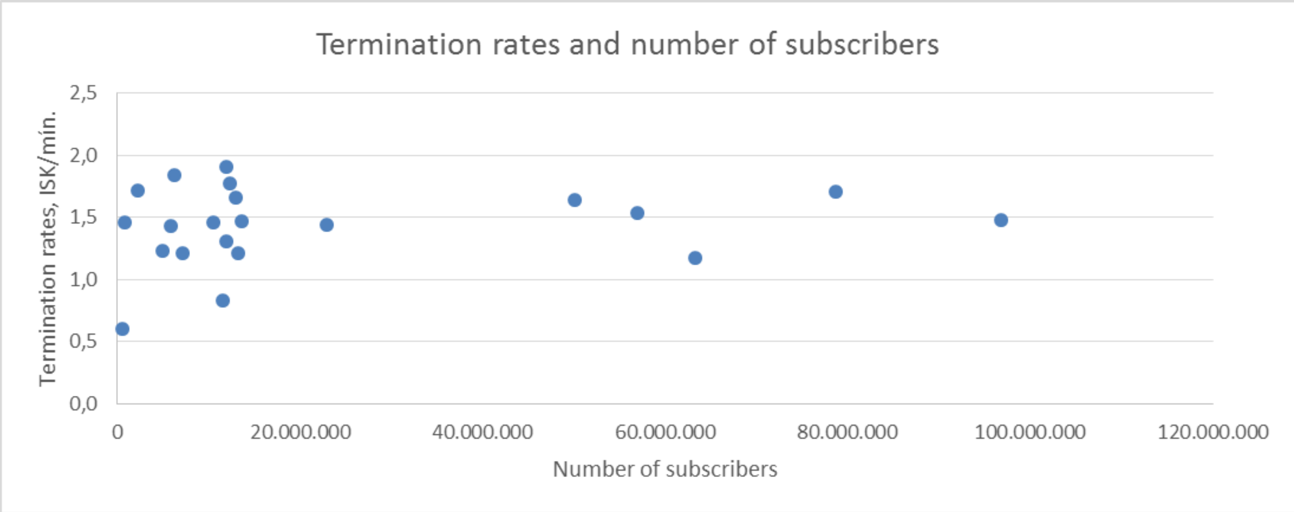


In Norway, which is a rather sparsely populated country, the conclusion from a BU-LRIC model was that the cost of mobile phone call termination was ISK 1.43/minute. This price is just under the existing average of those States which calculate mobile phone termination rates on the basis of a BU-LRIC model.

The following figure shows termination rates of States on the basis of number of mobile phone subscriptions.

[table legend:
Title - Call termination rate and number of subscribers
y-axis - Call termination rate ISK/min. x-axis - number of mobile phone subscribers]

[3] Number of mobile phone subscriptions 2013 according to ITU: http://www.itu.int/en/ITU-D/Statistics/Pages/stat/default.aspx



In Malta, the number of subscribers is very low, about 560,000, but the conclusion from their model was ISK 0.608/minute, which is considerably lower than the current termination rate in Iceland. From this it is not possible to determine that termination rates are higher in comparison countries that are sparsely populated, or that have small populations. In the opinion of the PTA, reducing the number of countries in the comparison would not be an improvement. In addition to this the Recommendation prescribes that electronic communications regulatory bodies that use benchmarking shall decide termination rates that are not higher than the average termination rate in those countries that use the pure BU-LRIC model.

In addition to this Siminn considers that by using benchmarking, the PTA is not taking costs into account. This is totally wrong. With benchmarking the PTA is using the conclusions from a cost model where the cost for an electronic communications undertaking to develop and operate an efficient electronic communications network is estimated. All termination rates in the benchmarking are based on cost and the PTA therefore decides termination rates on the basis of average costs.

Siminn considers that one should interpret "analogous competition markets," in another manner than is proposed by the PTA and considers that most EU States cannot be covered by this concept. Siminn has on the other hand, failed to specify the criteria that the company considers appropriate when "analogous competition markets" are decided. One could however understand the Siminn observations to mean that the company would prefer the use of benchmarking for deciding a maximum termination rate rather than a detailed and burdensome cost analysis. Examples of sparsely populated countries that have a number of factors in common with Iceland are Sweden and Norway, but if one were to solely use those countries for reference, then this would lead to a lower termination rate because the termination rates in these states is now below the average of the states within the EEA that use the pure BU-LRIC model when deciding termination rates. As stated here above it is not possible to see that termination rates resulting from the pure BU-LRIC model are dependent on the number of subscribers or the number of subscribers per km^2. The PTA thus sees no reason to change the procedure for deciding termination rates that is proposed in the Draft Decision. This methodology has been applied three times in this country and is very clear and predictable for all parties to the market.

Siminn wished to note that the planned PTA Decision on termination of calls that originated outside Iceland but within the EEA, totally lacked a legal basis. Síminn made agreements on interconnection with foreign electronic communications undertakings like Vodafone, Deutsche Telekom, BT, Orange, TDC, TeliaSonera and others. Siminn could in no way whatsoever be considered to have a dominant market position against these companies. Siminn required access to networks abroad and this was based on agreements. The cost of making agreements and procedures with foreign companies was significantly higher than with Icelandic companies. Siminn wished to point out that the PTA Decision would place Icelandic companies in a very negative position against foreign companies which did not collect domestic termination charges for Siminn. With the PTA Decision, these companies could unilaterally decide to increase termination rates with respect to Siminn. Siminn strongly objected to the PTA becoming involved in transactions that the Administration had not investigated in any manner whatsoever. It was simply unthinkable that the PTA should put the contractual standing of Icelandic companies in a very negative position against electronic communications giants which had enormous turnover and which were not subject to similar obligations as those that the PTA intended to impose on Siminn.

The Administration appeared to assume that termination rates decided by electronic communications authorities in each country applied to telephone calls between electronic communications undertakings within the EEA. It was not established where PTA sought the authority to impose such an obligation on Siminn, and this had not been the practice in agreements with foreign electronic communications undertakings. Siminn agreements with foreign counterparties were bilateral agreements where the companies agreed on traffic to and from their networks. It was important that Siminn continued to be free to make agreements with other electronic communications undertakings on a level playing field as such obligations were not borne by electronic communications undertakings within the EEA. It would have a very negative impact if Siminn were obliged to accede to such obligations while the counterparty was authorised to price his telephone calls on cost criteria.

Siminn considered there to be reason to make the above specified observations as the planned PTA Decision seemed to a large extent to lack appropriate legal basis. Regardless of other considerations, the PTA had not in any way investigated the aspect related to electronic communications traffic from abroad. Should a decision be made to impose obligations on Siminn with respect to transactions with foreign electronic communications undertakings, it was clear that such a decision would be totally without legal basis. Apart from this, the PTA would put Icelandic electronic communications undertakings in a significantly negative position as their counterparties were not subject to analogous obligations and the pricing of these parties was not decided by the PTA, as is the case with termination rates of domestic electronic communications undertakings.

The position of the PTA

The article in question in the Preliminary Draft withdraws the obligation for maximum termination rates with respect to telephone calls that originate outside the EEA. This withdrawing of the obligation on such telephone calls has precedent in a number of European analyses of the same market and was the occasion for BEREC to publish an opinion on this matter on 5 June 2015, which says that this may be considered normal as European mobile phone companies are subject to obligations on termination rates while companies outside the area are not. European countries have a weak position in making agreements with companies outside the EEA if they are bound by maximum termination rates within the EEA, but with the withdrawing of price obligations on telephone calls originating outside the EEA this imbalance is levelled. The opinion in question is not made public, but is intended for internal use by the NRAs.

The PTA furthermore considers that termination rates within EEA are harmonised and for this reason the maximum termination rate prescribed in one EEA State applies to termination of telephone calls that originate from other areas.

In addition to the maximum termination rate, costs accrue from international telephone calls for interconnection, which in Iceland goes through expensive connections by submarine cable and there are costs that accrue for handling and settlement. The additional price imposed on termination rates of telephone calls for such factors is not encompassed by PTA obligations and is negotiable in agreements between electronic communications undertakings. The market for termination of international calls is very active and companies are often looking for the most advantageous terms.

Mobile phone companies are also active in offering termination to foreign telephone companies, regardless of whether the call is to their own customers or whether it terminates in the network of another mobile phone company. The telephone call is then simply transited to the company with whom the recipient is a subscriber.

Termination rates in Europe have dropped very significantly, subsequent to market analyses and the imposition of obligations in an analogous manner as to what has happened in this country. Such reduction of termination rates is seen in agreements of European mobile phone companies on interconnection for termination of international telephone calls. The PTA is aware of the fact that Icelandic mobile phone companies receive a demand for reduction of agreed termination rates when the maximum rate according to obligations is reduced with PTA Decisions.

The PTA thus plans not to change the article in question in the Preliminary Draft as it provides Icelandic companies with greater rights in agreements with foreign electronic communications undertakings on termination of calls that originate outside the EEA.