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EFTA SURVEILLANCE
AUTHORITY

Póst- og Fjarskiptastofnun
Sudurlandsbraut 4
108 Reykjavík,
Iceland

For the attention of:
Mr. Hrafnkell V. Gíslason
Managing Director

Dear Mr Gíslason,

Subject: Wholesale tariff for the Metropolitan Data Highway (MDH) connections on the market for wholesale trunk segments of leased lines in Iceland - Remedies

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

I. PROCEDURE

On 23 November 2015, the EFTA Surveillance Authority (“the Authority”) received a notification of a draft national measure in the field of electronic communications pursuant to Article 7 of the Framework Directive from the Icelandic national regulatory authority, *Póst- og fjarskiptastofnun* (“the PTA”). It concerns the wholesale tariff for Metropolitan Data Highway (“MDH”) connections on the market for wholesale trunk segments of leased lines in Iceland.²

The notification became effective on the same day.

National consultation was carried out, pursuant to Article 6 of the Framework Directive, during the period 19 October 2015 to 9 November 2015.

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 14 of the EFTA Surveillance Authority Recommendation (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 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 “2004 Recommendation”).

On 8 December 2015, a request for information³ (Document No 783352) was sent to the PTA, and a response was received on 12 December 2015 (Document No 784558).

The period for consultation with the Authority and the national regulatory authorities (“NRAs”) in the EEA States pursuant to Article 7 of the Framework Directive expires on 23 December 2015.

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

II. DESCRIPTION OF THE DRAFT MEASURES

II.1. Background

In its Decision No. 21/2015,⁴ the PTA designated Mila ehf. (“Mila”) with significant market power (“SMP”) on the wholesale market for trunk segments of leased lines. Furthermore, the PTA imposed obligations on Mila regarding access to trunk segments of leased lines, non-discrimination, transparency (publication of reference offer), price control and cost accounting, and accounting separation. In particular, the PTA required Mila to prepare a cost model for the calculation of the wholesale prices of trunk segments of leased lines based on fully-allocated historical costs (“FAC HC”).

In addition to the above, the PTA published four parallel decisions, i.e. Decision No. 22/2015, 23/2015, 24/2015 and 25/2015, relating to four different cost analyses and tariffs for different categories of services in the wholesale market for trunk segments of leased lines.⁵ PTA Decision No. 24/2015 related to the cost and tariff assessment for the MDH connections.

The notified draft decision is a recalculation of prices for Mila’s MDH connections in accordance with Mila’s price control obligations. Furthermore, with the notified draft decision the PTA proposes to authorise Mila to offer MDH connections with 100 Gb/s capacity between specific locations delivered as 1 x 100 Gb/s or 10 x 10 Gb/s.

MDH is a service that suits customers that require broadband connections between several locations. It is transmitted across a passive network, which means that there are only active devices at the end of the connections. MDH connections can therefore fulfil a similar purpose to the Ethernet services. However, in contrast to Ethernet services, MDH connections normally also include part of the fibre access network.

According to the PTA’s Decision No. 24/2015, dated 12 August 2015, the lease price for a 1 Gb/s MDH connection was to remain unchanged at ISK 95,000 per month while the

³ Pursuant to Article 5(2) of the Framework Directive and Point 13 of the Authority’s Procedural Recommendation (EFTA Surveillance Authority Recommendation of 2 December 2009 on notifications, time limits and consultations provided for in Article 7 of the Act referred to at point 5c1 of Annex XI to the Agreement on the European Economic Area (Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services), as adapted by Protocol I thereto, OJ C 302, 13.10.2011, p.12, and available on the Authority’s website at <http://www.eftasurv.int/media/internal-market/recommendation.pdf> (“the Procedural Recommendation”).

⁴ Notified to the Authority on 1 July 2015 and assessed by the Authority on 3 August 2015, Case No 77596, Document No. 763837.

⁵ Notified to the Authority on 1 July 2015 and assessed by the Authority on 3 August 2015, Case No 77597, Document No. 764757.

lease price for a 10 Gb/s MDH connection was to increase from ISK 120,000 to ISK 160,000 per month. The start-up charge for an MDH connection was to remain unchanged at ISK 107,000 per connection. The increase in the tariff for 10 Gb/s MDH connections would come into force on 1 October 2015.

II.2. Current notification

The notified draft decision is in accordance with Mila's obligations on transparency and price control which were imposed in the PTA's Decision No. 21/2015. According to that Decision, amendments to Mila's tariffs are dependent upon endorsement by the PTA. The current draft decision follows from Mila's submission of a new cost analysis to the PTA in October 2015 which took into account *i.a.* a significant decrease in prices of equipment and an increase in the number of MDH connections with 10 Gb/s capacity. Furthermore, changes that would result from offering 100 Gb/s MDH connections and the consequent impact on the cost of 1 and 10 Gb/s MDH connections were taken into account.

The following sets out the key elements of the PTA's assessment of Mila's updated cost analysis for MDH connections in Iceland:

II.2.1. *Weighted average cost of capital (WACC)*

The PTA considers that the real WACC for an electronic communications company in Iceland is 7.4% for the year 2014 in calculations of the rate of return for capital tied in assets used in connection with the company's provision of services.

The PTA notes that Mila's proposed calculations for the WACC are in accordance with the PTA's considerations.

II.2.2. *Operational expenditure ("OPEX")*

OPEX is based on Mila's estimate of maintenance costs and of other operational costs, composed of hosting in technical space, electricity and lease of fibre-optic lines.

In its evaluation of Mila's cost analysis, the PTA points out that, according to its Decision No. 21/2015, OPEX shall be based on the prior financial year in each instance. This approach is, however, considered unrealistic in the case of a completely new product which is developing rapidly. MDH is a relatively new product for Mila and there is not yet much experience of maintenance costs for the system. In addition, Mila has replaced much of the system equipment during the short space of time that the product has been on offer. In the same manner as in the last MDH cost analysis, Mila has thus calculated maintenance costs as a proportion of annual capital cost (instead of using booked costs), and the same proportion is used for 1 and 10 Gb/s MDH connections as was used when calculating the maintenance cost of Mila's Ethernet service as laid down in PTA's Decision No. 23/2015.

In addition to maintenance costs, costs are calculated for hosting in equipment space, electricity and fibre-optic lease. These calculations are also in accordance with the calculations performed in the previous MDH cost analysis.

Further to the above, the PTA does not intend to object to Mila's proposed methodology for calculating OPEX.

II.2.3. Investment costs (“CAPEX”)

CAPEX is based on investments for MDH connections during the period 2010 until July 2015 and Mila decides the replacement cost on the basis of CAPEX for these years.

Mila’s cost analysis indicates that equipment that was initially purchased has been replaced and that the price of the equipment has decreased significantly. Mila chose to amend calculations from the previous analysis in such a manner that the investment in equipment was removed from the calculations. Mila decided the replacement cost by using the price of other equipment from the most recent purchase of equipment.

Mila uses the same kind of categorisation of investment between 1 Gb/s MDH and 10 Gb/s MDH connections as was used in the last analysis. In addition, Mila allows for a five-year useful life of the investments in 1 and 10 Gb/s MDH connections, which is the same as was allowed for in the previous MDH cost analysis.

Mila estimates CAPEX for 100 Gb/s MDH connections on the basis of the cost of the equipment in which the company needs to invest to be able to offer these connections. Mila considers a four-year useful life to be adequate for this equipment as it is assumed that the price of such equipment will steadily decrease, given developments in recent years.

Mila makes the condition for leasing 100 Mb/s MDH connections based on the requirement for a binding agreement for a term of three years. Mila justifies the necessity for such a long period of commitment based on the fact that the investment entails a significant risk and that there are few possible customers.

The PTA does not intend to raise objections to Mila’s proposed methodology for calculating CAPEX. Nor does the PTA intend to object to the three-year binding timeframe, taking account of the limited demand for this product and of the inherent investment risk.⁶

II.2.4. Set-up charges

Revenue from set-up charges is deducted from CAPEX. Mila proposes an unchanged set-up charge of ISK 107,000 per connection regardless of the connection capacity.

The PTA does not intend to raise objection to Mila’s proposal in this regard. Set-up charges are considered in accordance with such charges for leased lines and Ethernet connections offered by the company on this market.

⁶ In its response to the Authority’s request for information, the PTA explained that investment in equipment and spare parts is necessary to provide the service and that monitoring and management of 100 Gb/s MDH connections is considerably more substantial than for other connections.

As regards the expected impact on competition in related markets, especially with respect to smaller electronic communications providers, the PTA noted that the 100 Gb/s product will allow major operators to consolidate the transport of data for data centres and that the lease of such a product would be disproportionate for most companies with only one or two major electronic communications companies as the exception. Taking account of the scope for the 100 Gb/s connections to facilitate increased efficiency in data transport to data centres, the PTA explained further that the addition of 100 Gb/s connections can also lower the cost for smaller operators in the long run and make it possible to introduce new services.

II.2.5. Number of connections

Further to the inclusion of 100 Gb/s MDH connections, it is proposed to allow for a corresponding reduction in the number of 10 Gb/s MDH connections.

II.2.6. Conclusions

Further to the above-specified criteria, the PTA accepts Mila's revised price calculations and proposes to fix the set-up charges and monthly lease charges for the MDH connections as follows:

Service type	Wholesale tariff
Set-up charge	ISK 107,000 per connection
1 Gb/ connection	ISK 95,000 per month
10 Gb/s connection	ISK 120,000 per month
100Gb/s connection	ISK 655,000 per month

The PTA also accepts Mila's request to offer 100 Gb/s MDH connections and that the agreement for a 100 Gb/s MDH connection shall be binding for three years.

The new tariff will apply from the start of the month after the 60-day notice period has passed and is to be reviewed on an annual basis⁷.

In its response to the Authority's query concerning efficiency reconciliations, the PTA noted that replacement costs are used for calculating the investment cost and that operational cost is mainly based on regulated unit prices. The PTA did not deem it necessary to perform a benchmarking analysis based on comparable prices in other countries.

III. Comments

The Authority has examined the notified draft measure and has the following comment:

Need to ensure an efficient and predictable approach to setting wholesale tariffs

The considerable degree of reliance on Mila's own costing information is underlined in the present draft measure by the fact that the PTA is already revising Mila's tariffs for MDH connections after these tariffs were only determined by way of a decision in August 2015.⁸ While recognising that the PTA utilises an FAC HC method for setting tariffs in the relevant market, the Authority nonetheless reminds the PTA, in line with the objectives of the EEA regulatory framework,⁹ of the need to avoid multiple tariff changes by verifying that the costing information it receives from the SMP operator during the annual tariff review process is consistent with the promotion of efficiency and regulatory stability throughout the regulatory period in question.

⁷ Pursuant to PTA Decision No. 21/2015.

⁸ Pursuant to PTA Decision No. 24/2015.

⁹ See, for example, the Authority's comments in Case No. 74047 where it is noted that, when setting regulated prices in line with the EEA regulatory framework for electronic communications, NRAs should seek *inter alia* to: (i) promote efficiency and sustainable competition, (ii) ensure that end users enjoy maximum benefits, and (iii) encourage efficient investment in infrastructure. Promoting regulatory stability, consistency and proportionality are further guiding principles of the regulatory framework.

IV. Final remarks

On a procedural note, the Authority recalls that any future amendments to, or more detailed implementation of, the draft remedies consulted on in the current notification will require re-notification in accordance with Article 7(3) of the Framework Directive.

Pursuant to Article 7(5) of the Framework Directive, the PTA shall take the utmost account of comments of other regulatory authorities and the Authority. It may adopt the resulting draft measure and, when it does so, shall communicate it to the Authority.

The Authority's position on the current notification is without prejudice to any position the Authority may take in respect of other notified draft measures.

Pursuant to Point 15 of the Procedural Recommendation,¹⁰ 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 days¹¹ following receipt of this letter if you consider, in accordance with EEA and national rules on confidentiality, that this letter contains confidential information which you wish to have deleted prior to publication. You should give reasons for any such request.

Yours sincerely,


Ólafur Jóhannes Einarsson
Director
Internal Market Affairs Directorate


Emily O'Reilly
Deputy Director for Competition
Competition and State Aid Directorate

¹⁰ The Procedural Recommendation.

¹¹ The request should be submitted through the eCOM Registry, marked for the attention of the eCOM Task Force.