

Appendix IV



PÓST- OG FJARSKIPTASTOFNUN

Conclusions of the additional PTA consultation on the Decision with respect to cost analysis for bitstream access according to Access Options 1 and 3

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1 Introduction

This document contains an overview of the replies and comments received in the Post and Telecom Administration (PTA) additional consultation on the draft Decision with respect to cost analysis for bitstream access according to Access Option 1 (Market 5). The initial draft was presented to stakeholders for consultation on the Administration's website on 21 February 2014 and the consultation was thus concluded last 11 March. The additional consultation document can be found in Appendix III

The following parties submitted comments to the PTA draft to amendments to the preliminary draft:

- Fjarskipti ehf. - hereafter named Vodafone
- Siminn hf. -Hereafter named Siminn
- Hringiðan ehf. - hereafter named Hringiðan
- Símafélagið ehf. - hereafter named Símafélagið

No comments were received from Mila on the additional consultation but the PTA sent Siminn comments to Mila for comment. The Mila responses to Siminn comments are thus specified where appropriate.

With respect to the Vodafone comments the PTA did not consider that to be necessary to send them to Mila, as similar comments from Vodafone had been sent to Mila for comment in consultation on another matter which related to the Mila request for amendments to the companies reference offer for bitstream access, which took place at the same time, see discussion here below.

Comments are categorised by subject. 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.

As is mentioned in the consultation document for the additional consultation under discussion here, see Appendix III, new information came to light with respect to the use of wholesale switches for Access Option 1 from the prior national consultation. There it was stated that the wholesale switches had been used for services other than was specified in the initial Mila cost analysis which meant that the use of the wholesale switches was different and more extensive than was established when the consultation on the preliminary draft was opened.

Subsequently Mila decided to offer other parties on the market the service that Siminn had received from Mila, that is to say access to wholesale switches for corporate connections, connections with mobile phone transmitters and backbone connections. In this connection Mila submitted on last 21 February a proposal for an amendment to the companies reference offer for bitstream access where this new service was taken into account and a new tariff for access to wholesale switches and xDSL equipment,

where applicable. The Mila tariff in the reference offer took into account the PTA conclusion on amended price for access to wholesale switches that the PTA had already communicated to Mila and that had been presented in the additional consultation. The amendment to the reference offer for bitstream access was submitted for consultation at the same time as the additional consultation on cost analysis for access to wholesale switches for Access Option 1. That matter will be processed in parallel to the matter here under discussion and to the market analyses of Markets 4 and 5.

2 Change in Section 8 on wholesale switches

Vodafone mentions that it still believes that wholesale switches are unnecessary and that it would be best to discontinue its use. Access Option 1 is the only product on offer for bitstream access that requires a special investment in an electronic communications equipment for purchasers to be able to provide service, that a company on the market is obliged to provide. Vodafone points out that such a decision by the PTA could be a precedent for other markets and that this is a risky route for the PTA to take. Vodafone considers, as the company has pointed out before, that it would be most appropriate to include the costs accrued with providing the service into the monthly charge for each subscription, as is customary on the electronic communications market.

The position of the PTA

The Mila cost analysis of wholesale switches here under discussion comes subsequent to Decision no. 38/2012 where the use of wholesale switches was prescribed and the relevant charges.

It is stated in the PTA preliminary analysis that from the time that the above specified decision was published, circumstances have changed and more experience has been gained on the use of wholesale switches. The PTA considers that in the next cost analysis for bitstream access, which will be a total review of the Mila tariff, the question will be examined as to whether one should view costs for wholesale switches as part of total costs for the company's access system and whether this cost should thus be included in the price for bitstream access, regardless of whether one or more parties request access. Until such a total review is available, the PTA considers it necessary to make a Decision on price for the wholesale switches in question as was prescribed in the above specified PTA Decision no. 38/2012. Those prices then apply up to the total review in question and will be the basis for Settlement between Mila and Vodafone and other parties that have used Access Option 1 where the wholesale switches in question are being used.

Vodafone points out that it has been shown that Mila use of the wholesale switches has been in another manner than the PTA allowed for in its Decision no. 38/2012. As it is confirmed that Skipti is using the wholesale switches for other internal and external services than solely Access Option 1, all grounds for a special charge for wholesale switches being set for Access Option 1 have disappeared. It would be impossible for the PTA and for the market to assess whether Mila is pricing the share in wholesale switches in a proper manner by varying services. It is therefore in the opinion of Vodafone inconceivable to continue collecting charges for wholesale switches for Access Option 1 if one is to ensure non-discrimination between parties on the market.

The position of the PTA

The main reason for review of the main components of the tariff for bitstream access or for them being priced for the first time in this cost analysis is the PTA Decision no. 38/2012. Among other things the Decision prescribes cost analysis of start-up costs and of capex and opex and it prescribes that a new tariff be decided on that basis for wholesale switches and for access prices that would apply from and including 1 February 2013. The new tariff should among other things be used in the settlement of transactions between Siminn (now Mila) and Vodafone. On this basis and on the basis of uncertainty about the development of use of wholesale switches, the PTA considers it unwarranted to change the structure of the tariff at this stage, but rather to work towards changes, which Vodafone considers positive, in the next cost analysis.

Vodafone points to the fact that the PTA has notified that it has commenced an investigation on whether the above specified conduct by Mila constitutes a breach of the non-discrimination obligation which rests on Mila (previously Siminn) with respect to the offer of wholesale services and the breach of the transparency obligation by offering one party such a service without first updating the reference offer. Vodafone considers it very important that the Administration complete the above specified investigation and reach a conclusion on whether Mila has breached the Electronic Communications Act. Vodafone also considers it important that it be examined how debt collection has been conducted between Mila and Siminn from 1 September 2013 for the use of those ports that were used for other services than Access Option 1 and in addition to this that the Administration ensure that the tariff for the service that will be on offer in the future is published openly. The PTA conclusion in this matter could have a significant impact on other companies on the electronic communications market.

The position of the PTA

This issue is not directly covered by the cost analysis for Access Options 1 and 3 and is being examined in a special case by the PTA.

Siminn comments on the PTA changes with respect to pricing of ports in wholesale switches. The PTA proposes that a purchaser of the Mila service pays ISK 9,218 for each 1 Gb/s port and ISK 14,862 for each 10 Gb/s port. Pricing is not dependent on use, that is to say that pricing is the same regardless of whether 1 port of 24 is used or all 24. Mila revenue per month could thus be in the range of ISK 9,218 up to ISK 221,232 per month given full use of 1 Gb/s ports.

This means that costs for electronic communications companies in using the equipment will increase but hardly in any degree commensurate with the cost incurred with the increased use. In the opinion of Siminn, Mila is always assured of being paid for the first port for 36 months.

Siminn takes an example of the disadvantage that Siminn considers the pricing in question to create. If one company connects to the equipment with one port then this will cost ISK 9,218 which means that Mila will receive a minimum payment of ISK 331,848 for 36 months with the addition of the setup fee. With the addition of one more party the revenue will double and become 663,696 for 36 months. In the event

of half of the ports being used then the costs to all purchasers would be ISK 3,982,176 from this single switch which is ISK 1,327,392 per annum etc.

The average cost for each company if only two ports are used would on a monthly basis be ISK 36,872 from one switch. With an analogous arrangement for 10 switches then the costs for this one item would be about ISK 370 thousand per month which represents ISK 4.4 million per annum. If both companies were using 6 ports each on 10 wholesale switches then the cost for each party would be about ISK 2.2 million per annum or ISK 6.6 million for 3 years. Total revenue for 10 wholesale switches would then be ISK 13.2 million given these premises. There is in addition to this the setup fee for connection for Access Option 1.

Siminn points out that Mila revenue and consequently costs for customers increases linear by increase in the number of ports. At some point in time, revenue will thus be far in excess of cost. As there is not a linear relationship between costs and increase in use, it is normal in the opinion of Siminn that pricing should not have this relationship either.

In the Mila reply, Mila agrees with the view that that there is not a linear relationship between increasing costs and increased use. For this reason the additional ports that are used for GSM transmitters or corporate connections should be less expensive than those that are used for Access Option 1, and this was the initial intention with the methodology when the cost analysis was sent to the PTA last autumn. There is a risk as pointed out by Siminn that the service will have little use other than for Access Option 1 as one only needs a very small number of ports for it to be more economic to install alones own equipment rather than lease from Mila. Wholesale switches are expensive to purchase and it is for this reason that the need to have certain characteristics to be able to perform the security role for which they are intended for Access Option 1. These characteristics would not need to be in place if it were not for Access Option 1 with TV service. It is therefore logical that GSM and corporate connections pay a lower price for their use, as those connections do not employ all of the characteristics of the equipment.

The position of the PTA

Siminn assumes in its calculations that the monthly price per port remains unchanged for the next 3 years regardless of whether use of the ports changes and hence the port price. These are not valid premises as it is planned to review these prices annually and it is assumed that the part of the cost of the wholesale switch which concerns service for Access Option 1 will be included in the price for Access Option 1 in the next cost analysis.

Siminn also assumes in its comments that Mila customers are obliged to pay a monthly fee for 3 years which is in accordance with the Mila proposal for amendments to the reference offer for bitstream access. The PTA points out that the Administration has not endorsed the Mila proposal for three-year contractual duration as such is not in accordance with prior practice that the Administration has up to this point in time endorsed in cost analyses.

Initially it was proposed that the price per port would change according to use in each switch. Mila was opposed to the price per port changing by use and by number of customers in each wholesale switch and pointed out that such an arrangement would be extremely complex to implement with high maintenance and high error risk. This methodology would have led to varying prices at each location depending on use and number of customers. Mila proposed that the reference should be current use at the time the cost analysis was made and that the price should be recalculated on an annual basis to take into account changed use.

The arrangement now proposed by the PTA, that is to say to split costs on the basis of use at the point of time when the cost analysis is made has been the practice in other areas. Siminn is correct in saying that in those instances where use is increasing there is a risk that income of the company in question will exceed costs and furthermore the reality is that in the event of a reduction in use there is a risk that revenue will not support costs.

Monthly charges are calculated on the basis of capex and opex of the 26 switches that were installed in September 2013 and on their use in January 2014. The average use of these switches did not increase much from September to last January, in fact by about 1%. It is not clear precisely how the use of the switches will develop and where the use of new switches will prove to be analogous to that of those that have already been installed, for example whether they will be located outside the capital city area where use is somewhat less. For this reason it is important that cost of wholesale switches be recalculated on an annual basis.

The use of the ports has a deciding impact on their pricing and annual review is intended to ensure that the tariff is corrected in accordance with the real use of ports, whether use increases or decreases. With respect to the Mila comments on choice of equipment and its cost, the PTA points out that choice of equipment and its characteristics were in the hands of Siminn (now Mila) which is a result of the Siminn demand with respect to the supply of Access Option 1 and not for other service, see the PTA Decision Decision no. 38/2012.

Siminn considers it to be sensible and more in accordance with the objectives of the Electronic Communications Act that are intended to support economic electronic communications, see Article 1 of the Act and the objectives of the Competition Act which should support efficient use of manufacturing capacity, see Article 1 of the Act, that pricing subsequent to the first port is lower or takes into account the nature of the connection where possible. Otherwise there is a risk that the cost of using the equipment will lead to it being more economic for the company in question to use its own equipment rather than purchase services from Mila. In all events it is unwise to price each port at the same price and thus prevent purchasers from enjoying efficient use of the equipment. This pricing could even lead to the service in specific areas becoming unprofitable, for example where pricing becomes higher than customer willingness to pay for the product. Under such circumstances, pricing of a product could lead to there being no demand for it. This could also lead to each individual company installing its own equipment which would possibly have inferior utilisation with the result that the underlying cost for each connection would be higher than necessary.

Siminn points out that the first proposal for the service in question had been that prices would decrease with increased use of ports, that is to say that the entry of each new party would lead to a reduction in price of the service. If more parties used the ports then this should be to the benefit of others. The latter proposal by the PTA, which is now being amended, had the effect that all ports after the first port would be at a lower price.

Siminn considers that this method is more sensible than the one currently being proposed, that is to say pricing each port at the same price as this methodology will lead to lack of efficiency both in investments and use. Vodafone has maintained that the pricing of ports initially proposed by the PTA, that is to say varying prices for the first port and for ports in excess of 1, only benefits Siminn. Despite the Vodafone assertions this has the same impact on all parties that wish to use the equipment in their operations. Taking use into account and the nature of the use it should benefit other companies and not only Siminn.

Siminn assumes that the service being discussed by the PTA is, or will be on offer for all parties from the time that a final Decision from the Administration on pricing is issued. Should Vodafone be interested in using more ports then this should also benefit Vodafone and reduce the pricing of each port in excess of 1. This would lead to more economical use and pricing of service that Vodafone could purchase instead of investing in its own equipment.

If a wholesale switch is used then there will in all likelihood be inevitable costs, such as investment and installation. This cost does not change whether 1 port is used or 24. In order to be able to maximise use of the equipment, the pricing needs to be based on demand for the service in order to recoup the investment and fixed costs, that is to say that the pricing of the ports should aim towards meeting variable costs and in addition be such that total use provides adequate returns for a specific period, whether this is for 3 years or for longer period. The proposal now on the table goes in the opposite direction, that is to say it leads to the inhibiting of the incentive to use the equipment.

For this reason Siminn considers that the product, service should be priced in such a manner that there is an incentive for the purchaser to make better use of it. To design pricing in such a manner that there is an incentive not to use the equipment or use it unwisely, is illogical and economically wrong. As an example of pricing which would encourage competition and support more efficient use would be for example if a quantity discount was offered and as steady reduction in price of ports as more ports are used.

In all events pricing must be such that it does not lead to a negative conclusion for the purchaser of the service as business increases, and for this reason one must take economy of scale into consideration, that is that the cost for each port decreases as use increases. Such a methodology is positive for the seller and the buyer as they can both maximise their profit with sensible use of the required input.

In the Mila reply it is stated that pricing is based on current average use of all wholesale switches. Some switches will thus be operated at a loss and others at a profit, as the calculations apply to the whole. If use increases then this will be reflected in the new cost analysis which should be implemented annually according to the new's proposal for market analysis. On the other hand it complicates invoicing to alter price calculations, as hinted at by Siminn, each month depending on how use of ports changes. Annual cost analysis should suffice in the opinion of Mila.

The position of the PTA

As previously stated, Mila was opposed to the arrangement first proposed, that the price for port in wholesale switches would change according to use and number of customers in each wholesale switch. Mila pointed out that such an arrangement would be extremely complex to implement and that error risk and maintenance would be high. This methodology would have led to varying prices at each location depending on use and number of customers. Mila proposed that the reference should be current use at the time the cost analysis was made and that the price should be recalculated on an annual basis to take into account changed use.

Mila proposed that the price for ports in excess of 1 should be lower than for the first port. This is the arrangement that the PTA cannot accept in the light of the nature of the use of the switches.

The average price of 1 Gb/s ports with Siminn would only be half of the average price that Vodafone would pay if one were to apply the Mila proposal for calculation of equivalence for ports in excess of 1. It is therefore clear that with this arrangement, there would be discrimination between Mila customers. The arrangement here being proposed by Siminn, to have ports in excess of 1 less expensive, would first and foremost be particularly advantageous to Siminn and it is unlikely that other companies would benefit from this arrangement.

In the consultation it came to light that the wholesale switches were being used for services other than DSL service. The cost of wholesale switches should therefore be split between these varying service offers and it is normal that this is applied in accordance with the use of each service. If the full price is only paid for the first port in each switch then this would cause a discrepancy in the allocation of costs to varying services offers as with this arrangement DSL service would bear greater cost than other service options, such as backbone network and mobile phone service. This would mean that consumers of bitstream service would subsidise other services such as GSM service. If one were to take the Siminn views into account that ports in excess of 1 would be less expensive than the first port and the view that each service bore a share of costs in accordance with use then this would result in a significantly increased level of complexity in the tariff and uncertainty about recovery of costs. With the changes in monthly charges proposed by the PTA, the cost is split equally between service options and furthermore the cost is split between those that use wholesale switches in accordance with their use.

Siminn mentions that in all events, pricing must be implemented in such a manner that it does not lead to a negative conclusion for buyers of the service as business increases. The arrangement with respect to monthly charges for the wholesale

switches proposed by the PTA does not lead to a negative conclusion for buyers of the services as business increases as the monthly charges are independent of the number of connections with each Mila customer.

The PTA does not agree with Siminn that one has to take Siminn economy of scale into account when calculating monthly charges for Mila wholesale switches and that in this way one should support the incentive to purchase access to the switches. If one considers the history of this matter then the purpose with these switches was to make it possible for Vodafone to gain access to Siminn (now Mila) xDSL service through Access Option 1. According to what was stated by Siminn at that time, the wholesale switch was a prerequisite for being able to provide such access. One may consider that the cost of the wholesale switch is an access barrier to Access Option 1 for Vodafone and for other electronic communications companies. As the position is today, Vodafone therefore does not have a choice as to whether it uses the wholesale switch or not for the provision of VDSL service according to Access Option 1. In the opinion of the PTA it has more significance to minimise the costs for access to the wholesale switches for Access Option 1 than to support inexpensive corporate connections that could be resolved in another manner. In the next cost analysis of bitstream, the share of DSL service in wholesale switches will probably be included in the general access price for bitstream and at the same time other access to wholesale switches will be reviewed.

Siminn also draws attention to the fact that in the prior PTA's consultation it was stated that Mila would collect an alteration charge for ADSL over to VDSL but the pricing was not specified. In the current consultation no references made to the alteration charge for this reason it would be useful if the PTA would confirm whether such an alteration charge was planned and if it had been discussed at the PTA. In all events it is necessary that it be established that transfer from ADSL to VDSL should not be interpreted as a setup fee.

The position of the PTA

The overall review of setup and alteration charges will be reviewed in the cost analysis which is planned subsequent to the forthcoming PTA Decision on Markets 4-5. One can expect a final Decision on this matter in the first quarter of 2015. These are setup fees for local loops with new connections, for the taking over of xDSL service and for changes from ADSL to VDSL in Access Options 1 and 3.

Until the results of that cost analysis are available the existing charge of ISK 3,166 will apply to changes from ADSL to VDSL and this charge is in accordance with the PTA Decision no. 30/2011, see Appendix II for further details. Because of the Vodafone comments with respect to the takeover of xDSL service (change of service provider) Mila proposed that in those instances a lower charge would be collected. Mila proposed that the charge for taking over xDSL service would be ISK 1,329 in accordance with the analysis sent by Mila to the PTA in the year 2011. The PTA plans to accent the use of this charge until the new cost analysis is available.

Vodafone is very happy with the PTA recommendation that the settlement between parties for the difference between temporary prices and final prices according to this cost analysis will take place within one month from the date of this decision.

Vodafone considers that final settlement needs to take place for the setup fee for wholesale switches and that it is assumed that wholesale switches will be discontinued.

In addition to this Vodafone considers it important that electronic communications companies can approach the PTA should a dispute arise with respect to switches and that the Administration should assure smooth progress in this matter and that electronic communications companies do not suffer further damage in the Settlement process.

The position of the PTA

It is prescribed in the PTA Decision no. 38/2012 that the final settlement between parties for the difference between temporary prices and final prices according to this cost analysis will take place within one month from the date of this decision. Should a dispute arise on the settlement then the company in question can approach the PTA with such a matter and the PTA will issue a ruling in the case.

Vodafone states that the company is in favour of the changes proposed by the Administration in the special additional consultation on the cost analysis for bitstream access according to Access Options 1 and 3. Vodafone repeats however that the company considers wholesale switches to be unnecessary in the provision of the service. Should the use of wholesale switches not be discontinued, Vodafone considers it important for it to be clearly stated that their use is solely limited to Access Option 1.

The position of the PTA

In the opinion of the PTA, Vodafone has not provided adequate arguments for why the use of wholesale switches should be limited to Access Option 1. The use of wholesale switches has an impact on the monthly price of the switches and if one were not to be able to use them for other services than Access Option 1, the monthly price would increase. The above-specified Vodafone opinion is not in accordance with Vodafone's prior arguments to the effect that one should not charge for individual investments in system components but solely for the cost accrued as a result of the service in question.

Though wholesale switches were planned first and foremost for Access Option 1, the PTA does not consider there to be a reason to hinder the use of free ports in another manner as this will provide better utilisation of the investment in question which will result in lower prices for access to Access Option 1.

The PTA finally states that the Administration has a specific case in process which relates to the Mila request for amendment to the reference offer for bitstream access to the effect that it should be possible to use wholesale switches for services other than Access Option 1. A Decision in this case is expected shortly after the Decision in the case here under discussion and the Decision with respect to the market analysis on Markets 4 and 5.

3 Other comments

Hringiðan comments on the fact that there is no longer a price difference between ADSL and VDSL connections as the company had disposed of the difference between ADSL ports and VDSL ports for the purchase of VDSL point of service equipment. This equipment is more expensive and it takes approximately 12 months to pay up the cost difference in the equipment.

The position of the PTA

As is stated in the position of the PTA to comments received in the prior consultation, see Appendix II, the development in distribution of the VDSL system caused changes in price structure of ADSL and VDSL services. The conclusion of the calculation was that there was a very insignificant difference in the cost of ADSL and VDSL connections and for that reason it was decided to level these prices. Various factors can influence how costs are divided and efforts are made to apply a causal relationship where this is possible. The revenue model of varying electronic communications companies is on the other hand not one of the factors which decide how costs are split.

Símafélagið submitted comments where it was stated that the company had observations to make with respect to limited additional consultation on cost analysis for access to wholesale switches with Mila for Access Option 1 (Market 5). Símafélagið comments on Appendix 5 to the Mila reference offer for bitstream access and particularly with respect to item 3 (Tariff) for reports for use other than for Access Option 1.

The position of the PTA

The PTA considers the comments from Símafélagið to be first and foremost directed at amendments to Appendix 5 to the Mila reference offer for bitstream access with respect to Access Option 1 and to specific additional services in that option, and the PTA initiated consultation on amendments to the reference offer at the same time as the additional consultation on cost analysis for access to wholesale switches. For that reason the PTA intends to deal materially with the Símafélagið comments in the processing of comments received from the consultation on amendments to the reference offer.