

Maltacom's Reference Unbundling Offer

Statement of Preliminary Decision

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Malta Communications Authority

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Executive Summary

The publication of a reference offer for unbundled access to the local loop is a Regulatory obligation mandated on operators with a Dominant Market Position (DMP) operating in the Fixed Electronic Communications Market.

As a DMP operator in Malta, Maltacom is obliged to publish a Reference Unbundling Offer (RUO), which includes commercial, technical and operational terms and conditions for unbundled access to the local loop.

Following the publication by Maltacom of its RUO, the MCA proceeded with a review of this RUO focusing predominantly on the following:

- A general review of the commercial, technical and operational terms and conditions with a focus on compliance with the minimum set of items and conditions to be included in the RUO as set out in the Fourth Schedule of Legal Notice 412/2004,
- A detailed review of the underlying costing information supporting the service prices set out in the RUO with the objective of ensuring transparency and cost-orientation of the prices for each of the LLU (Local Loop Unbundling) services offered.

This preliminary decision describes briefly the MCA’s initial assessment of Maltacom’s RUO. Following the relevant consultations with Maltacom and other stakeholders, the MCA shall proceed with the publication of its final Decision.

1 Introduction

The “local loop” refers to the physical twisted metallic pair circuit connecting the network termination point at the premises of the subscriber to the main distribution frame or equivalent facility in the public switched telephone network.

A “local sub-loop” is a partial local loop connecting the network termination point at the premises of the subscriber to a concentration point or a specified intermediate access point in the fixed public telephony system.

Local Loop Unbundling (LLU) can be offered as either full-unbundled access or shared access to the local loop. Full-unbundled access allows the provision to “Other Authorised Operators” (OAOs) access to the local loop or local sub loop of the notified operator, authorising the use of the full frequency spectrum of the twisted metallic pair. On the other hand, shared access to the local loop means the provision to an OAO of access to the local loop or local sub loop of the notified operator, authorising the use of the non-voice band frequency spectrum of the twisted metallic pair – in this case the local loop continues to be used by the notified operator to provide the telephone service to the public¹.

The implementation of Local Loop Unbundling has the ultimate aim of enhancing competition and fostering the provision of affordable electronic communications services to end-users. The underlying assumption as described in the EU Directive is that it would not be economically viable for new entrants to duplicate the dominant operators’ metallic local access infrastructure in its entirety within a reasonable time. Therefore, unbundled access to the local loop allows new entrants to compete with the dominant operator in offering high bit-rate data transmission services as well as voice telephony services.²

¹ Electronic Communications Networks and Services (General) Regulations 2004 Fourth Schedule (Regulation 18).

² Regulation (EC) No.2887/2000 .

2 Legislative Background

2.1 General

In September 2004 the Telecommunications (Regulation) Act (Cap 399) was significantly amended to transpose the New EU Framework for Electronic Communications. The Telecommunications (Regulation) Act was renamed as the Electronic Communications (Regulation) Act. Since the revised legislation established new rules for the regulation of electronic communications, it also set out a transitional period whereby the obligations which existed as at 1 May 2004 would still apply until the market analysis is carried out in line with Regulation 17 of LN 412/2004.

The obligations relating to this Interim Decision were already applicable to Maltacom immediately before the coming into force of the amendments. This Decision is therefore being published in accordance with the transitory provisions of the Electronic Communications (Regulation) Act.

2.2 Malta Communications Authority Act

Article 4(3)(c) of the Malta Communications Authority Act states that the MCA shall regulate and secure interconnectivity for the production, transmission and distribution of services, products, operations or activities relating to any matter regulated by or under the Act.

Article 4(3)(d) states that the MCA shall ensure fair competition in all services, products, operations or activities relating to any matter regulated by or under the Act.

2.3 Electronic Communications (Regulation) Act

Article 2 of the Electronic Communications (Regulation) Act defines access as the making available of facilities and, or services, to another undertaking, under defined conditions, on either an exclusive or non-exclusive basis, for the purpose of providing electronic communications services.

It covers *inter alia* access to network elements and associated facilities, which may involve the connection of equipment, by fixed or non-fixed means (in particular this includes access to the local loop and to facilities and services necessary to provide services over the local loop), access to physical infrastructure including buildings, ducts and masts and access to relevant software systems including operational support systems.

Article 13 of the Electronic Communications (Regulation) Act states that the MCA shall, acting in accordance with its objectives as stated in the Malta

Communications Authority Act, encourage and where appropriate, ensure, in accordance with the provisions made by or under this Act, adequate access and interconnection and interoperability of services in such a way as to:

- (a) promote efficiency;
- (b) promote sustainable competition; and
- (c) give the maximum benefit to end-users.

Article 14 (4) states that an operator of public communications networks shall offer access and interconnection to other undertakings on terms and conditions consistent with obligations relating to access and interconnection imposed by the Authority in accordance with this Act.

2.4 Electronic Communications Networks and Services (General) Regulations

Regulation 17 of the Electronic Communications Networks and Services (General) Regulations states that the MCA shall impose obligations identified in Regulations 18 to 22 as appropriate on any operator designated as having SMP.

Regulation 18 (1) states that the MCA may in accordance with the provisions of regulation 17 of these regulations, impose obligations for transparency in relation to interconnection and, or access, requiring operators to make public specified information, such as accounting information, technical specifications, network characteristics, terms and conditions for supply and use, and prices.

Regulation 18 (2) states that the MCA may, in particular where an operator has obligations of non-discrimination, require that operator to publish a reference offer, which shall be sufficiently unbundled to ensure that undertakings are not required to pay for facilities which are not necessary for the services requested, giving a description of the relevant offerings broken down into components according to market needs, and the associated terms and conditions including prices. The Authority shall, furthermore, be able to impose changes to reference offers to give effect to the obligations imposed under the Act and under these regulations.

Regulation 18 (3) states that the MCA may specify the precise information to be made available, the level of detail required and the manner of publication.

Regulation 18 (4) states that where an operator has obligations under regulation 21 of these regulations concerning unbundled access to the twisted metallic pair local loop, the MCA shall ensure the publication of a reference offer containing at least the elements set out in the Fourth Schedule of these regulations.

Regulation 21 (1) of the Electronic Communications Networks and Services (General) Regulations states that the MCA may impose obligations on operators to meet reasonable requests for access to, and use of, specific network elements and associated facilities, in particular, in situations where the Authority considers that denial of access or unreasonable terms and conditions having a similar effect would hinder the emergence of a sustainable competitive market at the retail level, or would not be in the end-user’s interest.

2.5 Electronic Communications (Unbundled Access to the Local Loop) Regulations, 2003.

Regulation 3 of the Electronic Communications (Unbundled Access to the Local Loop) Regulations states that these regulations shall apply to unbundled access to the local loops and related facilities of notified operators, and this without prejudice to the obligation of notified operators to comply with the principle of non-discrimination, when using the public fixed telephony system in order to provide high speed access and transmission services to third parties in the same manner as they provide for their own services or to their subsidiaries or affiliated businesses in accordance with Maltese law.

Regulation 4 (2) states that the reference offer shall be sufficiently unbundled so that the beneficiary does not have to pay for system elements or facilities which are not necessary for the supply of its services, and shall contain a description of the components of the reference offer and associated terms and conditions including charges.

Regulation 5 (1) states that notified operators shall from such date as the Authority may establish in the Gazette meet reasonable requests from beneficiaries for unbundled access to their local loops and related facilities, under transparent, fair and non-discriminatory conditions.

Regulation 7 (1) states that the MCA shall ensure that charging for unbundled access to the local loop fosters fair and sustainable competition and may for this purpose issue such directives as it may consider necessary.

Regulation 7 (2) states that the MCA shall have the power to:

(a) impose changes on the reference offer for unbundled access to the local loop and related facilities, including prices, where the Authority considers such changes to be justified; and

(b) require notified operators to supply it with information relevant for the implementation of these regulations.

Regulation 7 (3) provides that the MCA may, where justified, intervene of its own initiative in order to ensure non-discrimination, fair competition, economic efficiency and maximum benefit for users and subscribers.

2.6 Transitory Provisions

Article 39 (1) of The Electronic Communications (Regulation) Act states that an undertaking shall continue to comply with any obligations concerning access and interconnection under this Act as previously entitled as the Telecommunications (Regulation) Act and any regulations made thereunder including under the Telecommunications (Unbundled Access to the Local Loop) Regulations applicable to it immediately before the coming into force of this Act until such time as the said regulations are amended or as specific obligations pursuant to a market analysis undertaken by the MCA in accordance with the provisions of this Act, are imposed on any undertaking designated under article 9 of this Act.

Article 39 (2) stipulates that the MCA shall give notice as it considers reasonable to any party affected by the amendment or withdrawal of obligations referred to in sub article (1).

3 Process Review

3.1 Background

In May 2002 the Malta Communications Authority (MCA) designated Maltacom plc as having a dominant market position (DMP) in the public fixed telephony services market.

As a result of the above designation, the MCA issued Notice 173 in the Government Gazette dated February 20, 2004 wherein it established that Maltacom was to publish a reference offer for unbundled access to its local loops and related facilities by not later than April 30, 2004.

Maltacom submitted a draft version of the Reference Unbundling Offer (RUO) to the MCA in October 2004, and a copy of this document was eventually published by the MCA on October 5, 2004 for consultation. The consultation period ended on December 10, 2004 where no responses were received.

The MCA has undertaken a review of the RUO with particular emphasis on the underlying cost structures establishing the RUO prices. During the review process Maltacom continued to update its RUO. These updates have also been reviewed by the MCA.

3.2 Process

Following the submission of the draft RUO by Maltacom, the MCA initiated a detailed review of the RUO in order to ensure that this is consonant with established regulatory practices and that the wholesale prices offered are based on the principles of cost orientation, transparency and non-discrimination.

A general review of the RUO was undertaken in order to ensure compliance with the minimum set of terms and conditions as mandated by the pertinent legislation.

The MCA requested Maltacom to provide access to the costing information and ancillary accounting data used in determining the wholesale prices listed in the RUO’s price list. An independent review of the costing information relating to the wholesale prices was carried out, with the objective of ensuring that the methodology applied in determining the RUO prices is based on best practice and conforms to the regulatory principles of transparency and cost-orientation.

4 Reference Unbundling Offer

4.1 General

The underlying objective of the regulatory framework requiring the publication of a Reference Unbundling Offer is to ensure affordable access for all end-users by enhancing competition and stimulating technological innovation. The RUO published by a DMP operator should offer unbundled access under transparent and non-discriminatory conditions.

4.2 List of Services

Maltacom’s RUO price list includes the following services under the following main categories:

1. Metallic Path Facility – Full Unbundling Service;
2. Metallic Path Facility – Shared Access Service;
3. Collocation Services.

The Schedule to the Electronic Communications (Unbundled Access to the Local Loop) Regulations of 2003 establishes a minimum list of services to be included in a reference offer for unbundled access to the local loop.

A number of services from the minimum list are not featured in Maltacom’s RUO. In the course of the consultations, it resulted that Maltacom is in the process of compiling these services.

Decision 1:

The following is a list of items which have to be included in Maltacom’s Reference Offer by not later than Friday 19 August 2005:

- **Conditions for Unbundled Access to the Local Loop**
 - **Information concerning the availability of local loops in specific parts of the access network.**
- **Co-location Services**
 - **Information regarding the notified operator’s relevant sites, including co-location options at these sites³,**

³ This information can be restricted to interested parties if the MCA retains that there are public security concerns – LN 45 of 2003.

- **Conditions for beneficiaries to inspect the locations at which physical collocation is available, or sites where co-location has been refused on the grounds of lack of capacity.**
- **Supply Conditions**
 - **Lead Time for responding to requests for supply of full and shared access services and facilities,**
 - **Service Level Agreements (SLA’s),**
 - **Quality of service parameters,**
 - **Standard Contract terms, including, where appropriate, compensation provided for failure to meet lead times,**
 - **Installation and Rental Charges for:**
 - **Dedicated and Co-Mingling Collocation**
 - **Virtual Collocation**
- **Prices for Sub-Loop unbundling**

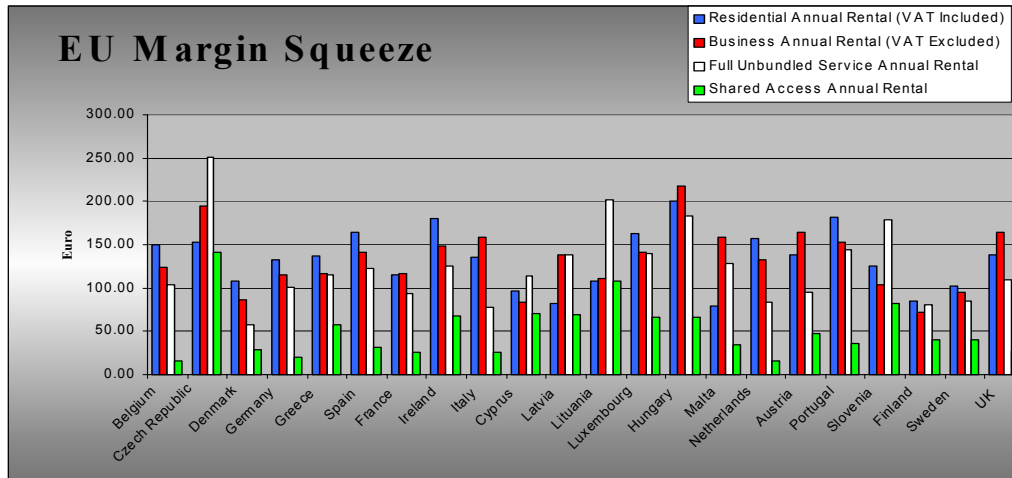
4.3 Margin squeeze

Margin squeeze refers to a situation in which a vertically integrated dominant operator uses its control over an input supplied to downstream OLOs preventing them from making a profit on a downstream market (i.e. retail market) in which the dominant operator is also active. The dominant operator could in theory exercise this in a number of ways as follows:

- ✓ raise the input price levels so that OLOs could no longer sustain a profit downstream,
- ✓ engage in below cost selling in the downstream market, while maintaining an overall profit through the sale of upstream services,
- ✓ raise the price of the upstream input and lower the price of the downstream retail product/service to create a margin squeeze.

This can be tested by judging whether the vertically integrated firm’s downstream arm could operate profitably with the wholesale charges paid by downstream competitors. Based on the proposed LLU prices for full unbundling and Maltacom’s existing residential line rental of Lm30.78 (inclusive of 18% VAT) a substantial margin squeeze exists.

Margin squeeze tends to be a problem where line rentals are not fully rebalanced. It is a common problem in the initial introduction of LLU. The table below provides an overview of residential and business line rental and annual charges for full unbundling and shared access for 21 of the EU member States.



Margin squeeze appears to be a problem in most of the new Member States, however it tends to be more pronounced in Malta due to the relatively low residential line rental (which is amongst the lowest in the EU).

The existing margin squeeze is likely to act as a deterrent to potential new entrants in the market, particularly in the case of full unbundling. The MCA would like to see the size of the margin squeeze brought down gradually over a reasonable period of time. This can be achieved through a combination of cost reductions and efficiency gains (which would in turn result in lower LLU prices) and potential increases in the residential line rental price.

This has been the observed trend in the EU, where LLU prices have tended to fall over time with slight increases in retail line rental (prompted largely by regulatory intervention) thus closing the gap between retail tariffs and full unbundling.

4.4 Overview of the key issues arising from the review of Maltacom’s proposed RUO prices

Following its review of Maltacom’s offer, the MCA has identified certain cost accounting issues which need to be addressed by Maltacom. The MCA shall be discussing these issues in more detail as part of the process leading to the finalisation of the RUO Review. These issues include:

4.4.1 Cost base

The MCA understands that the proposed RUO prices are based on Maltacom’s 2003 regulatory accounts. No adjustments have been made for any cost savings and efficiency gains that may have been made by Maltacom since 2003 as well as any further savings anticipated for the period for which the RUO will be made available.

4.4.2 Estimation of the one time connection fees

In estimating the one-time connection fees, Maltacom has included certain data on the labour hours required to provide the service.

At face value the labour hours indicated by Maltacom to provide one-time connection appear to be on the high side. In this respect Maltacom should provide a justification for the use of the labour hour estimates as calculated in the proposed one-time connection fee.

4.4.3 Use of mark-ups

In estimating the cost of the one-time connection fees, Maltacom is claiming a return on its labour cost and material usage.

When providing an interconnect or wholesale service to another operator, the MCA would expect the incumbent to provide a tariff based on the costs of providing that service plus a reasonable return on its capital employed in providing that service.

In its calculations, Maltacom is not claiming a return on its capital employed in providing the one time connection, but has applied a mark up on the labour cost and material usage equivalent to the operating profit before exceptional items divided by labour cost for 2003, and current WACC rate respectively.

The MCA strongly believes that there is no justification for claiming a return on operational costs and therefore any mark-ups used in computing the proposed prices (including those used in the one-time connection fees and annual cost of shared access) should be eliminated from the proposed prices.

4.4.4 Inclusion of overheads in proposed prices

- a) The labour cost per hour used in Maltacom’s estimate of certain costs (such as the one time connection fees) includes an estimation of overheads. Overall these overheads amount to circa 45% to 50% of the total labour cost per hour. Whilst the MCA is not averse to a certain level of overhead recovery, the percentages used by Maltacom appear to be significantly on the high side when compared to industry norms. Maltacom should provide a

detailed justification for the use of any overhead recovery rates if these are to be included in the RUO prices.

- b) The full unbundling and shared access annual charges include an allocation of general overheads. The MCA believes that a substantial element of these costs (such as listing fees, compliance with Stock Exchange regulations, entertainment and similar costs) may be out of scope for the purposes of determining the RUO prices.

4.4.5 Allocation methodology used in computing recurrent charges

In calculating the recurrent charges for full unbundling and shared access Maltacom seems to allocate fully certain costs, such as overheads, to both the full unbundling and shared access. This could give rise to a potential over recovery of costs.

4.4.6 Proposed prices for internal and external tie cables

Maltacom’s internal and external tie cables prices are based on a minimum cable requirement of 100 and 400 metres respectively, with additional minimum bundles of 100 and 400 metres being offered.

The material usage, especially the minimum lengths of the additional bundles to be unbundled, may be on the high side compared to the material usage conditions offered by other operators.

The MCA is therefore considering whether the additional bundles above the minimum cable requirements may need to be offered in lengths of 20 metres for internal tie cables and 100 metres for external tie cables.

5 Conclusion

This Preliminary Decision describes the MCA’s initial assessment of Maltacom’s RUO following the review carried out. In the coming weeks, the MCA shall be conducting detailed consultations with Maltacom so that the key issues identified in this Preliminary Decision will be addressed and where necessary amend and/or update the Reference Unbundling Offer.

Following this consultation period, the MCA will then publish its final Decision regarding the Reference Unbundling Offer published by Maltacom.

Joseph V Tabone

Chairman

1 August 2005