
Access to the public telephone network at a fixed location

**Identification and Analysis of Markets,
Determination of Market Power and Setting of Remedies**

Response to Consultation and Decision

20th September 2006

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Executive Summary

The current regulatory framework for electronic communications networks and services which entered into force in Malta on the 14th September 2004 is designed to create harmonised regulation across Europe and is aimed at reducing entry barriers and fostering prospects for effective competition to the benefit of consumers. The basis for this framework are five EU Directives.

The new Directives require National Regulatory Authorities (NRAs), amongst other things, to carry out reviews of competition in communications markets to ensure that regulation remains appropriate in the light of changing market conditions. For a limited period, while those reviews are conducted and until the new Significant Market Power (SMP) conditions are imposed, parts of the regulatory regime which existed prior to the 14th September 2004 continue to be in force in line with Article 39 and 40 of the Electronic Communications (Regulation) Act.

This document sets out the Malta Communications Authority's (MCA) decision for the market review of the 'Access to the public telephone network at a fixed location' market. A national consultation was carried out between the 14th October 2005 and the 31st December 2005.

As required by Article 7 of the Framework Directive (as implemented by Regulation 6 of the Electronic Communications Networks and Services (General) Regulations), the MCA's proposals have been notified to the European Commission.

Summary of Conclusions

Identification of Markets

The group of products and services under consideration in this document consists of access products to the fixed public telephony network. At present in Malta, access to the fixed public telephony network is provided either through analogue exchange lines, cable access or digital exchange lines (ISDN BRA and PRA). Three new access networks using broadband wireless access (BWA) technology will be in operation by the end of 2006.

In relation to these services, the MCA has identified the following relevant markets in accordance with competition law principles:

1. Residential analogue, cable and broadband wireless access lines provided over fixed public electronic communications networks.
2. Residential ISDN BRA access provided over fixed public electronic communications networks.
3. Non-residential analogue, cable and broadband wireless access lines provided over fixed public electronic communications networks.
4. Non-residential ISDN BRA access provided over fixed public electronic communications networks.
5. Non-residential ISDN PRA access provided over fixed public electronic communications networks.

The details of the definition of this market, and the approach taken by the MCA when identifying these markets, are contained in **Chapter 02** of this document.

Assessment of Market Power

Based on the evidence presently available to the MCA and after having analysed the operation of these markets, and taken due account of the Commission's 'Guidelines on market analysis and the assessment of SMP' (SMP Guidelines), the MCA concluded that Maltacom plc. should be designated as having significant market power in all of the above mentioned markets. The main reasons justifying this designation are:

- very high market shares;
- limited countervailing buyer power;
- high economies of scale and scope;
- the undertaking being a vertically integrated provider; and
- high barriers to entry.

Full details of the MCA's decision and reasoning are contained in **Chapter 03** to this document.

Regulatory Implications

Given the position of dominance held by Maltacom plc in all of the markets for access to the public telephone network at a fixed location – i.e. its ability to behave to an appreciable extent independently of competitors, customers and ultimately consumers – the MCA is imposing the following conditions :

Access to wholesale inputs

1. Imposition of Carrier Selection and Carrier Pre-selection (with associated remedies of non-discrimination, transparency, price and cost accounting, and accounting separation)
2. Imposition of wholesale line rental or single billing solution (with associated remedies of non-discrimination, transparency, price and cost accounting, and accounting separation)

Retail remedies

1. Cost orientation of retail prices
2. Transparency and Non-discrimination;
3. Cost accounting and Accounting Separation;
4. Measures to counter the unreasonable bundling of services

Full details of these remedies, including their effect and the reasons for proposing to set these conditions, are contained in **Chapter 04** of this document.

Chapter 01 – Introduction

A new European regulatory framework for electronic communications networks and services entered into force on the 25th July 2003. The framework is designed to create harmonised regulation across Europe and is aimed at reducing entry barriers and fostering prospects for effective competition to the benefit of consumers. The basis for the new regulatory framework is five Directives:

- Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (“the Framework Directive”);
- Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities (“the Access Directive”);
- Directive 2002/20/EC on the authorisation of electronic communications networks and services (“the Authorisation Directive”);
- Directive 2002/22/EC on universal service and users’ rights relating to electronic communications networks and services (“the Universal Service Directive”); and
- Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector (“the Privacy Directive”).

The Framework Directive provides the overall structure for the new regulatory regime and sets out fundamental rules and objectives across all the new directives. Article 8 of the Framework Directive sets out three key policy objectives, which have been taken into account in the preparation of this consultation document, namely promotion of competition, development of the internal market and the promotion of the interests of the citizens of the European Union.

The Authorisation Directive establishes a new system whereby any person will be generally authorised to provide electronic communications services and/or networks without prior approval. The general authorisation replaces the former licensing regime. The Universal Service Directive defines a basic set of services that must be provided to end-users. The Access and Interconnection Directive sets out the terms on which providers may access each others’ networks and services with a view to providing publicly available electronic communications services.

These four Directives were implemented in Malta on the 14th September 2004. This was achieved via the entry into force of the Electronic Communications (Regulation) Act, 2004 (hereinafter referred to “ECRA”) and the Electronic Communications Networks and Services (General) Regulations, 2004 (hereinafter referred to “ECNSR”).

The Directive on Privacy establishes users’ rights with regard to the privacy of their communications was transposed into national legislation through the Processing of Personal Data (Electronic Communications Sector) Regulations of 2003 and the Electronic Communications (Personal Data and Protection of Privacy) Regulations of 2003.

The Directives require National Regulatory Authorities (NRAs) such as the MCA to carry out reviews of competition in communications markets to ensure that regulation remains appropriate in the light of changing market conditions.

Each market review is divided in three main parts:

- definition of the relevant market or markets;
- assessment of competition in each market, in particular whether any companies have Significant Market Power (SMP) in a given market; and
- assessment of what are the appropriate regulatory obligations which should be imposed given the findings on SMP (NRAs are obliged to impose some form of regulation where there is SMP).

More detailed requirements and guidance concerning the conduct of market reviews are provided in the Directives, the ECRA, the ECNSR and in additional documents issued by the European Commission and the MCA. As required by the new regime, in conducting this review, the MCA has taken the utmost account of the two European Commission documents discussed below.

01.1 Market Review Methodology

The European Commission has identified in its Recommendation, a set of markets in which *ex ante* regulation may be warranted. The Recommendation seeks to promote harmonisation across the European Community by ensuring that the same product and service markets are subject to a market analysis in all Member States. However, NRAs are able to regulate markets that differ from those identified in the Recommendation where this is justified by national circumstances. Accordingly, NRAs are to define relevant markets appropriate to national circumstances, provided that the utmost account is taken of the product markets listed in the recommendation (Regulation 6 of the ECNSR).

The European Commission has also issued Guidelines on market analysis and the assessment of SMP ("SMP Guidelines"). The MCA has also published a document outlining the guidelines on the methodology to be used for assessing effective competition in the Maltese electronic communications sector¹. The MCA is required to take these guidelines into utmost account when analysing a product or service market in order to assess whether the market under investigation is effectively competitive or otherwise (refer to Regulation 8 of the ECNSR).

As required by Article 7 of the Framework Directive and Regulation 6 of the ECNSR, the results of this market review and the proposed draft measures need to be notified to the European Commission and to other NRAs. The Commission and other NRAs may make comments within the one month consultation period. If the Commission is of the opinion that the market definition, or proposals to designate an operator with SMP or proposals to designate no operator with SMP, would create a barrier to the single market or if the Commission has serious doubts as to its compatibility with Community law, and issues a notice under Article 7(4) of the Framework Directive, the MCA is required by Regulation 6 of the ECNSR to delay adoption of these draft measures for a further period of 2 months while the Commission considers its position.

The MCA has collected market data from a variety of internal and external sources, including users and providers of electronic communications networks and services and from consumer surveys commissioned by the MCA, in order to carry out thoroughly its respective market definition and market analysis procedures based on established economic and legal

¹ Link to market review methodology: <http://www.mca.org.mt/library/show.asp?id=513&lc=1>

principles, and taking the utmost account of the Relevant Markets Recommendation and the Guidelines.

01.2 Consultation

As required by Article 10 of the ECRA, the MCA has published the results of the market reviews and provided operators the opportunity to comment on the findings prior to adopting the final proposals.

Furthermore, Regulation 6 of the ECNSR establishes that prior to adopting the draft measures proposed in the market review the MCA is required to notify the Commission with the findings of the market reviews, the proposed remedies and the outcome of the national consultation process.

The MCA carried out a national consultation process from Friday 14th October to 31st December 2005, during which the MCA received two responses from Vodafone Malta Ltd and Maltacom plc.

On the 8th May 2006 the MCA notified the draft Decision to the Commission. The Commission sent and published its 'Comments Letter' pursuant to Article 7(3) of Directive 2002/21/EC on cases MT/2006/0394-5 on 7th June 2006². The MCA has taken the utmost regard of these comments in its final decision.

01.3 Liaison with Competition Authority

Under Regulation 10 of the ECRA, the analysis of the markets must be carried out in accordance, where appropriate, with an agreement with the National Competition Authorities.

In line with the co-operation agreement signed on the 20th May 2005 between the MCA and the Office of Fair Competition (OFC)³, the MCA presented the results of this review to the OFC. The OFC submitted its opinion letter on the 4th November 2005, a copy of which is attached to this document in **Appendix B**.

01.4 Scope of this Review

This review considers the markets for access to the public telephone services provided at a fixed location in Malta, which includes all products and services which allow end-users to access any public fixed telephone network.

² Link to Comments Letter: <http://www.mca.org.mt/library/show.asp?id=837&lc=1>

³ Link to Memorandum of Understanding between MCA and OFC:
<http://www.mca.org.mt/library/show.asp?id=656&lc=1>

01.5 Structure of the Document

The rest of the document is structured as follows:

Chapter 02 presents the MCA's conclusions on the definition of the markets for access to the public telephony services in Malta. This section consists of a review of the market definition procedure and its scope, as well as demand side and supply side assessments at the retail level;

Chapter 03 presents the MCA's market analysis for the access markets and identifies whether these markets are effectively competitive or those undertakings with significant market power.

Chapter 04 provides a discussion of the general principles associated with remedies and outlines the remedies being imposed on the SMP operator.

Chapter 02 - Market Definition

Regulation 10 of the ECNS provides that before a market power determination may be considered, the MCA must identify the markets which are, in its opinion, relevant for the purpose of ex ante regulation in Malta and analyse those markets. In identifying the relevant markets, the MCA is required to take utmost account of all applicable guidelines and recommendations issued by the European Commission.

Paragraph 3.1 of the Commission's Recommendation on relevant markets of 11th February 2003 states that *'because market analysis is forward-looking, markets are defined prospectively taking account of expected or foreseeable technological or economic developments over a reasonable horizon linked to the timing of the next market review'*. The market definition has been carried out on a forward looking basis and, where it is thought possible that market conditions may change significantly during the time of this review, these changes are identified and discussed.

The Recommendation states in Paragraph 4 that retail markets should be examined in a way which is independent of the infrastructure being used, as well as in accordance with the principles of competition law. Again this approach is at the heart of the MCA's analysis. The MCA's approach in assessing the markets is based on an analysis of competition levels and an assessment of the extent to which switching among services by consumers constrains prices, irrespective of the infrastructure used by the providers of those services.

Where the proposed market definition differs from the Commission's Recommendation the difference is identified and justification given in the light of the national circumstances which justify this departure, in the manner prescribed by the Recommendation.

This chapter outlines the MCA's findings setting out the different markets that the MCA has identified, and giving reasoning for its conclusions.

In formulating the MCA approach to market definition, the MCA has paid the utmost regard to the Commission's Recommendation and the Comments Letter pursuant to Article 7(3) of Directive 2002/21/EC sent by the Commission to the MCA on 7th June 2006.

02.1 Background to the electronic communications sector in Malta

As at December 2005 the total population of Malta stood at approximately 400,000. According National Statistics Office figure's there are approximately 128,000 residential households and 30,000 non-residential units. These figures indicate the small geographic size of Malta and this is reflected in the relatively small scale electronic communications services/networks available. Nonetheless, the electronic communications sector has in the past decade experienced an impressive growth both in terms of the number of operators and the variety of services offered. A perceptible amelioration in the quality of delivery of such services has also been recorded.

During 2005 the contribution of the electronic communications sector towards the Gross Domestic Product was just under 3 per cent, which shows a significant contribution to value added in the economy. For further details on the performance of the electronic

communications sector in the Maltese economy and other relevant statistics refer to the latest Electronic Communications Market Review published by the MCA⁴.

In Malta, the incumbent fixed telephony services operator - Maltacom plc⁵ - is the only undertaking that provides fixed access and calls over a public switched telephone network (PSTN). The incumbent has over the past decade developed its ubiquitous network from one predominantly focused on fixed-line telephone services including an international gateway, to one which incorporates other types of electronic communications services including; data communications (including internet and VoIP), mobile telephony and wireless applications.

Another infrastructure with almost ubiquitous coverage in Malta is the cable network operated by Melita Cable plc⁶. This is a typical hybrid fibre coaxial (HFC) cable network, the primary use of which is the delivery and provision of cable television. The company undertook a network upgrade in the late 1990s in order to render its network bi-directional and thus be in a position to provide two-way communications. As a result, in 2000, it started offering high speed Internet access across its network via cable modem. Furthermore, as from July 2005 the operator started to offer an IP-based voice service. Given that to date it has not concluded any interconnection agreements with other local operations, subscribers to this product are not able to make off-net national calls. For the time being, the service enables subscribers to make on-net and international calls only. The MCA is aware that the operator started negotiations with the main public network operators to get the necessary interconnection.

02.2 Access to the public telephone network at a fixed location

The MCA is considering the provision of access to the public telephone network at fixed location in line with Article 26(2) of the Electronic Communications Networks and Services (General) Regulations 2004, that is, that the connection provided shall be capable of allowing end-users to make and receive local, national and international telephone calls, facsimile communications and data communications, at data rates that are sufficient to permit functional Internet access.

In defining the relevant markets the MCA has analysed a number of publicly available access products, that is, those provided through analogue exchange lines, digital ISDN exchange lines (Basic Rate Access and Primary Rate Access), and cable, mobile and broadband wireless access.

Standard analogue exchange lines

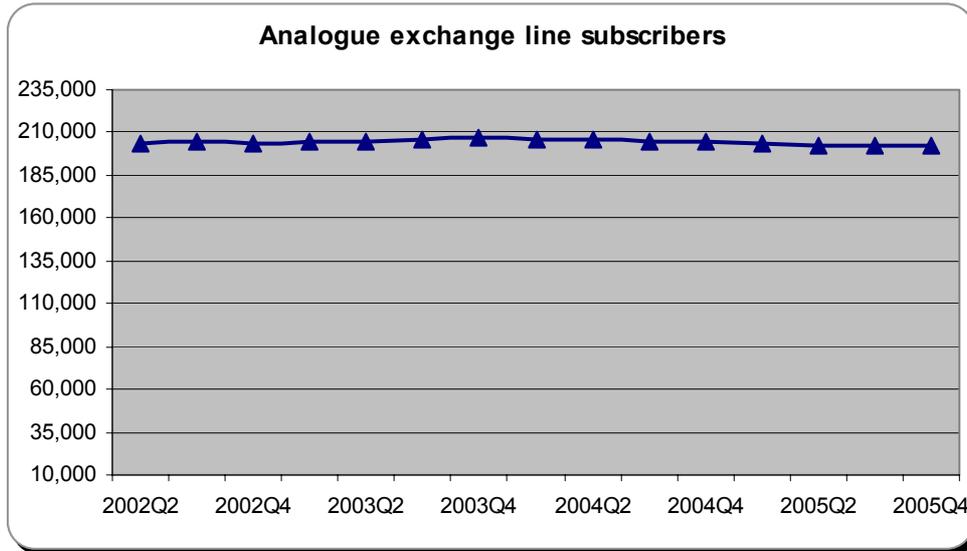
The analogue exchange line provides a single 64kbp/s channel, which supports voice as well as fax and data traffic with speeds of up to 56kbp/s.

At the end of December 2005, there were 202,116 basic analogue exchange lines in service. This is equivalent to a penetration of 50.5 lines per 100 inhabitants. The number of analogue exchange line subscriptions has remained stable over the past years.

⁴ Link to document on the MCA website: <http://www.mca.org.mt/library/show.asp?id=751&lc=1>

⁵ Hereinafter referred to as Maltacom

⁶ Hereinafter referred to as Melita Cable

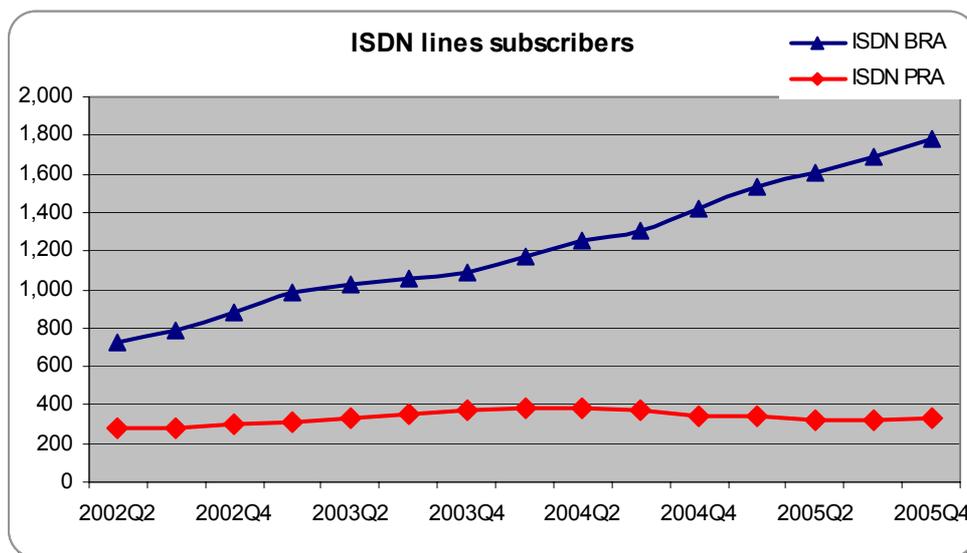


Digital ISDN exchange lines

Two categories of ISDN exchange line services are provided in Malta:

Basic Rate Access (BRA) - This is provided over the existing twisted pair subscriber line and can carry up to two simultaneous voice or data conversations (to the same or different locations). The two B channels can be combined for transmitting data at uncompressed speeds of up to 128Kbps.

Primary Rate Access (PRA) - This type of ISDN line is used mainly by medium and large sized enterprises and supports up to thirty 64kbp/s Bearer (B) channels and one 64kbp/s Data (D) channel. Another 64kbp/s channel is used for synchronisation purposes. Primary Rate Access ISDN can handle a total bandwidth of 2,048kbp/s.



As at the end of December 2005 the number of Basic ISDN lines stood at 1,310 and the number of Primary ISDN lines was 373. The number of basic ISDN lines is experiencing a small but constant increase whilst that of Primary ISDN lines has been stable for the past three years. All primary ISDN lines are used by business customers.

A user typically purchases access to the fixed telephone network in the form of an initial connection charge and a subsequent monthly rental (paid in advance). This applies to access via both analogue exchange lines and ISDN lines. Customers using standard analogue exchange lines have also the opportunity to opt for a prepaid scheme (*easyline*). Users opting for this scheme have their access and call charges directly deducted from their prepaid card. Users of this prepaid scheme are bound to spend a minimum amount worth of calls annually.⁷

Access over the cable network for fixed telephony services has been available since July 2005 when the cable operator launched an IP-based voice service for its subscribers. As at December 2005 there were approximately 3700 subscribers using cable access for the provision of its voice service.

02.3 Delineation of access markets in Malta

The delineation of the markets is based on an analysis of demand and supply substitutability between different products and services which could potentially form part of the market under investigation. This section provides an analysis of the degree of substitutability between available access products in Malta, taking also a forward looking approach with respect to possible developments in the market under review.

2.3.1 Access and calls at a fixed location

At present, both residential and non-residential customers purchase fixed access and calls as a cluster of services. Nevertheless, the cost of the two services can be distinguished since the cost for access and for calls is listed separately in the bill received by the customer.

However, the fact that fixed access and calls are supplied as a bundle does not necessarily imply that these products fall within the same relevant market. In order to assess if these products are substitutes or otherwise, demand-side and supply-side substitution factors will now be considered.

Demand-side substitution

As mentioned earlier, at present customers purchase both access to the public fixed telephone network and fixed calls as a cluster of services. Although customers may perceive access and call services as being one product (since they receive one bill) they are functionally different. Access services are an input to the capability of making calls over the fixed network. Customers cannot substitute fixed access to fixed calls since the latter is dependent on the other. This implies that although they may be perceived as one product, the two are not substitutes but rather complementary products. Proof of this is the fact that through the introduction of Carrier Select (CS) and Carrier Pre-select (CPS), end-users have the ability to purchase calls from one operator while buying access separately from another.

To date in Malta, apart from the incumbent which offers an international calls CS service on its own network, there is no alternative operator providing such facilities. Nonetheless, if a competing CS or CPS operator enters the market, customers would be able to switch operator if a hypothetical monopolist applies a significant non-transitory price increase in the price of calls. This would allow customers to purchase access and calls from a different

⁷ In order for a subscriber to continue to enjoy the *easyline* service a minimum of Lm38 (in the case of a residential subscription) and Lm75.00 (in case of a business subscription) worth of telephone calls must be made from the subscriber's telephone per annum, or such other minimum amount worth of telephone calls as Maltacom may decide in its sole discretion from time to time. In case of default Maltacom will migrate the *easyline* Service to the normal telephone line service.

operator, therefore, not binding them to buy access and calls as a cluster from the same operator.

The MCA is of the opinion that given the different functionality of the mentioned products fixed access and fixed calls cannot be considered to constitute a single market.

Supply-side substitution

The MCA considers that it is highly unlikely that any service provider which offers calls only such as CS /CPS operators would enter the access market during the timeframe of this review, if a hypothetical monopolist of access lines imposes a small but significant non-transitory increase in price of access lines.

Given the economies of scale and sunk costs involved in the construction of access networks, the MCA considers that there is no realistic possibility of supply-side substitution during the timeframe of this review.

Conclusion

The MCA considers fixed calls and fixed access to be complementary services and not substitutes and as a result they constitute separate markets.

2.3.2 Fixed and mobile access

Over the past years since competition in the mobile market was introduced the number of mobile users have increased dramatically. Currently, mobile penetration stands at around 81 per 100 inhabitants. It is thus relevant to consider whether access to a mobile telephone network is a good substitute for fixed access.

In this section, the MCA will be considering the extent to which a user would choose to access a telephone network using a mobile connection as opposed to a fixed connection and whether an undertaking currently providing mobile access would enter the market for fixed access in response to a small but significant non-transitory price increase.

Demand-side substitution

There are several factors, which in the opinion of the MCA make mobile access functionally different from fixed access. The most obvious feature is mobility, that is, that while one can access a mobile network irrespective of location, fixed services can only be accessed from a fixed point. In this sense, it is possible for users to substitute these types of access in one direction only, that is, by replacing fixed access by mobile access but not vice versa.

Another characteristic is the reliability of the service. Although mobile quality in Malta has improved considerably especially in terms of coverage, owing to the nature of mobile communications, the reliability of mobile access partly depends on the mobile phone, partly on the network and partly on other electronic communications services to which the network is connected. Mobile access might be adversely affected by a number of factors including:

- a large number people trying to use the network at the same time within the area covered by a particular base station,
- by physical features (such as high buildings, tunnels and densely built-up areas),
- by atmospheric conditions or
- by other causes of interference.

On the other hand, access via the PSTN network is comparatively more reliable than access through the mobile network as most of these adverse effects are not present.

Another distinct characteristic between fixed access and mobile access is the speed of data transfer that the different technologies are capable of carrying. The advent of GPRS in mobile telephony extended the ways in which people communicate. It is now possible for one to connect either through a GPRS enabled computer card or an infrared-capable GPRS mobile phone to a computer to achieve wireless connectivity to the Internet or office environment. However, GPRS can only reach typical speeds of around 40kbits/sec. This is relatively much slower in comparison to the speeds that can be reached via a fixed line access.

With the advent of 3G technology data transfer over mobile networks has improved dramatically, thus reducing the difference between mobile and fixed access for data transfer purposes. Two undertakings have to date been granted 3G frequency spectrum, and Vodafone has recently started offering 3G services with limited coverage. The MCA is of the opinion that its take-up will not have a significant impact during the timeframe of this review.

One also has to note that a fixed connection may be shared by a number of users, while a mobile connection is generally more personal and associated with a single user. Thus, the cost of access from a fixed location may be shared by a number of people.

When assessing the potential demand-side substitution of mobile access to fixed access, it is important to consider the extent to which fixed access users would switch their fixed line access with mobile access if the price of fixed line access were to increase. Due to the different pricing structures of mobile tariff plans it is very difficult to separate the charge for access from the charge for calls. Mobile access and calls are sold as a single bundle. It is therefore hard to compare the cost of fixed access (which excludes calls) with the cost of mobile access (access and calls bundled together). Appendix A shows the current price schedule for fixed access and calls, and some comparative analysis of the cost incurred by a user when calling from a mobile and a fixed line.

In comparing fixed line tariffs with mobile tariffs on a best deal basis, it is evident that there is still a considerable price differential. A person switching completely from fixed access to mobile would find that the cost of communicating would more than double. Hence, although retail mobile costs are decreasing, it is still not a feasible alternative for a user to substitute fixed access with mobile access.

In conclusion, when one considers the general price premium for accessing the network from a mobile phone and the existing functional differences between mobile access and fixed access, given an increase in the price of fixed line access, users will not substitute their fixed line access with a mobile access.

Supply-side substitution

In considering supply-side substitution, there appears to be few opportunities for substitution between fixed and mobile access services. Supply-side substitution would involve a mobile operator responding to a price increase in fixed access by switching production and offering fixed access. A mobile provider seeking to enter the fixed access market would need to provide a product that matched the price and quality of a fixed line. This would require either the construction of an access network or the development of a wireless product that more closely resembled the fixed access product. The high costs involved in developing such infrastructure render supply-side substitution unlikely during the timeframe of this review. Consequently, from a supply-side perspective the MCA deems fixed access and mobile access to be in separate markets.

Conclusion

The MCA considers fixed access and mobile access to constitute separate markets.

2.3.3 Different access products and networks

As mentioned earlier there are currently four access products on the market provided through a fixed connection namely, analogue exchange lines, two types of ISDN lines and cable access lines.

Demand-side substitution

The main question to ask in assessing demand-side substitution amongst these forms of fixed access is the extent to which consumers would be prepared to switch from one type to another in response to a small but significant non-transitory price increase.

Functionality

All the above mentioned access products are considered to be substitutable by the fact that they allow end-users to make and receive voice calls, faxes, and support data communications. While both voice or data connections on analogue exchange lines and ISDN access lines are set up by dialling up to a switched network, call-making on the existing cable infrastructure is completely packet based.

There are however some key functional differences in how these services can be and are utilised. While an ISDN connection can be seen as a bundle of multiple analogue exchange lines, this service provides the possibility to access data at greater bandwidth if more than one channel is available for connection. ISDN service is capable of very rapid connection without the need of a modem training sequence. Moreover, ISDN service users enjoy a wider range of enhanced supplementary services. However, unlike analogue lines, ISDN connections do not support DSL.

When it comes to PRA ISDN connections, which in Malta are only demanded by businesses, the difference in functionality is even starker. Currently, PRA ISDN access is used to connect large business PBXs that can support multiple extensions.

The MCA considers that access over the cable network is functionally the same and thus substitutable to the analogue access lines provided over the PSTN network. However, cable access is not considered to be a substitute to the ISDN BRA and PRA access products since the latter types of access products offer different functionality than the available cable access.

Pricing structure

From a pricing point-of-view as already explained, in order to access either analogue exchange lines or ISDN a customer needs to pay a one-off connection fee and a rental charge which is paid on a monthly basis by residential customers and on a bi-monthly basis by business customers.

The table below illustrates the charges in Maltese Lira⁸ (inclusive of VAT) per year associated with analogue exchange line, cable access, BRA ISDN and PRA ISDN.

	Analogue exchange lines	Cable access	BRA ISDN	PRA ISDN
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⁸ Exchange rate 1€ = Lm0.43

Connection Fee				
Residential	23.60	23.20* / 15.39 ⁺	30.00	
Business	47.20	34.15* / 30.00 ⁺	77.00	944.00
Annual Rental				
Residential	30.84	19.92	76.00	
Business	80.28	19.92	188.00	1550.00

Source: Maltacom and Melita Cable website

* Installation fee for Cable TV

+ Installation fee for Cable internet

A hypothetical monopolist in the provision of analogue exchange lines who attempts to raise its prices by a small but significant amount would find that its subscribers would not switch to BRA ISDN for a number of reasons, including:

- its higher connection fee and rental cost;
- the need to buy ISDN-specific end user equipment; and
- in the case of subscribers using only one analogue exchange line having to subscribe to an extra line which they do not require.

On the other hand, users currently using BRA ISDN are unlikely to switch to analogue exchange lines given a small but significant price rise in BRA ISDN. These users are unlikely to be willing to give up the extra functionalities inherent in the BRA ISDN line for an analogue exchange line.

The functionality, different use, and price differentials of PRA ISDN suggests that a change in price of analogue exchange line access or BRA ISDN access do not constrain PRA ISDN.

With regards to the cable access service, the cable operator charges a fixed monthly rate which compares well with the line rental for analogue access lines. It is therefore evident that price-wise cable access and standard analogue exchange line access are substitutable.

Supply-side substitution

In considering supply-side substitution, the key question to ask is whether an existing supplier would enter the market in response to a small but significant increase in price of fixed access by a hypothetical monopolist.

A potential substitute for the fixed access services currently provided by the PSTN and Cable networks is broadband wireless access (BWA). On the 12th October 2005 the MCA allocated frequency spectrum to three undertakings for the deployment of a national BWA network. The investment needed to enter the market for this type of access is a significant one and it would take a significant amount of time to deploy a network with nation-wide coverage. The MCA believes that operators using broadband wireless technology are unlikely to have an impact during the timeframe of this review. In any case, the provision of access services over broadband wireless networks would in the future be a potential substitute for the current available fixed access products.

Conclusion

Based on the evidence provided above, analogue exchange lines or equivalent access products over the cable network fall within the same relevant market.

BRA ISDN or equivalent products and PRA ISDN or equivalent products are not considered to be substitutes of analogue exchange lines, and cable access and therefore constitute separate markets. The two types of ISDN are also not substitutes to each other and are therefore further split into individual markets.

2.3.4 Residential and non-residential access

In its Explanatory Memorandum to the Recommendation on Relevant Markets, the European Commission stated that it may be appropriate to distinguish end user categories in the markets defined since it is common to distinguish between business and residential markets because the contractual terms of access and service may vary and because the economics of serving customers in the two locations may be significantly different.

At present, a customer may only apply for a residential service if he/she intends to use the line for purely residential purposes. The customer is obliged to apply for a business service if he plans to use or is using the telephone access for profit making purposes. There is no customer choice in the category to which they are assigned.

Demand-side substitution

Even though access to business and residential customers is functionally identical since it is provided over the same infrastructure and provide same quality of services, business and residential users have different needs. Business users tend to require a greater range of services and use access primarily to make calls. Internet access is usually achieved through single high-speed ADSL or Cable-modem connections shared throughout the organisation. Residential users on the other hand, need fewer value-added services and use their access line for making calls and connecting to the Internet

The ability to distinguish successfully between business and residential customers for essentially the same service is an indication that there are separate markets for business and residential access. This is based on the undertaking's ability to single out business customers with sufficient accuracy and to require that they utilise only the business service provided. It is not possible for a business subscriber to switch to a residential status when faced by a hypothetical price increase in access. The undertaking will not supply the residential service to a subscriber who will be using the line for business purposes.

There is also some differentiation between business and residential customers in the terms and conditions of supply. Business customers may benefit from enhanced service quality of service guarantees. This may include, for example, a shorter time to get a connection, or faster fault repair. Business and residential customers have different also billing arrangements – for example the incumbent's business customers are billed each month while the residential customers are billed on a bimonthly basis. From a marketing and sales strategy point of view, business and residential customers are also treated differently.

Under these conditions of supply and the fact that there is no undertaking that provides access to both residential and business subscribers with indiscriminate conditions of supply, indicates that from a demand-side perspective there is no possibility of substitution.

Supply-side substitution

With respect to supply substitution, the ubiquity of both the PSTN and the cable network implies that costs associated with supply are not substantially different for business and

residential customers. At a general level, an undertaking serving the business market may easily switch to supplying residential users in response to a small but non-transitory price increase by a hypothetical monopolist since the relevant network facilities required for such supply are similar.

Nonetheless, for potential market entrants, differences in the cost of supply would be relevant. Where a new access network has to be built then a potential market entrant could take into consideration the different areas of concentration of business and residential users respectively.

Conclusion

MCA's analysis of the conditions of the supply of business and residential services indicates that there is currently no possibility for demand side substitution. This indicates that at present, despite the potential supply side substitution, residential and non-residential services in Malta fall in separate relevant markets.

02.4 Relevant Geographic Market

A relevant geographical market comprises the area in which the undertakings concerned are involved in the supply and demand of products and/or services, in relation to which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different to those areas.

According to the EU Guidelines, in the electronic communications sector, the definition of the geographical scope of the relevant market is generally determined with reference to the area covered by a network, and to the existence of legal and other regulatory instruments.

Based on these definitions and the market conditions described earlier on, the MCA concludes that the relevant geographic market for the markets considered in this review is the Maltese Islands.

02.5 Summary of responses to the National Consultation and MCA replies related to the market definition

One respondent argued that the consultation document fails to discuss the increasing trend for customers opting for packages where access and calls are purchased as one single product. It added that the overall direction of change in the markets for fixed access and calls is towards increasing substitutability, and therefore recommends that access and calls are in the same relevant market.

The MCA does not concur with the arguments set out by the respondent. As stated in the consultation paper, although customers may perceive access and call services as being one product, access services are an essential input for users to be able to make calls. Customers cannot substitute fixed access to fixed calls since the latter is dependent on the other. The two products are not substitutes but rather complementary products.

In its submission the same respondent argued that the consultative document should have found that access over BWA networks falls within the same market that includes analogue exchange lines or equivalent products over other networks. The respondents argued that the

coverage obligations set out in the call for applications for prospective BWA networks justify this inclusion.⁹

The MCA has evaluated the above mentioned submission together with the three BWA licences granted on the 21st October 2005¹⁰. Two of the three BWA licensees have agreed to cover at least 90% of the national territory within two years of the grant of the spectrum, whilst the other undertaking agreed to achieve at least 66% coverage of the territory within the same period. It is therefore expected that during the timeframe of this review the roll-out of BWA networks would be at an advanced stage, thus allowing the potential for BWA operators to start providing services over their networks. Even though the MCA does not have any definite information as to whether these operators will start providing telephony services during the timeframe of this review, it nonetheless feels that such networks have the capability to offer access services within the timeframe of this review.

It is therefore appropriate to consider access services over the broadband wireless networks to be in the same relevant market.

One respondent argued that the limited substitutability between residential and non-residential access products, mainly through the setting of a different pricing structure, is not a conscious strategic decision but rather a historical remnant of pricing policies imposed upon the incumbent by policy makers. The respondent argues that given recent changes in pricing the differences between residential and non-residential prices should decrease considerably, thus making such a distinction irrelevant.

The MCA is cognisant of the historic developments of fixed telephony in Malta and is also keeping into consideration the proposed tariff changes that the incumbent is considering. Even though the approval of such changes would decrease the price differential between the two customer segments, it is still not possible at this stage to consider both customer groups as falling in the same market. A major reason for this is the fact that a business user cannot apply as a residential customer and vice versa. The incumbent is able to distinguish between applicants and only provides a specific type of access based on the characteristics of the applicant. Unless customers are able to decide in which category they want to apply for, the distinction between residential and non-residential customers will be justified.

02.6 Comments by the European Commission pursuant to Article 7(3) of the Framework Directive related to the market definition

In the draft measures notified to the European Commission, the MCA included Broadband Wireless Access in the relevant markets for residential and non-residential access lines provided over fixed public electronic communications networks. In their comments the Commission argued that the MCA has not conducted a substitution analysis before defining the relevant market. The Commission commented that the MCA has neither assessed whether end-users would consider switching from a fixed narrowband access product to a BWA product in the case of a small but non-significant price increase, nor the functionality of the BWA product. The Commission however recognise that the inclusion of this technology in the relevant market does not affect the finding of SMP or the scope of regulation.

⁹ Two operators will have at least 33% coverage by the end of 2006 and 90% coverage by the end of 2007 whilst the other will achieve 90% within four years of the grant of the spectrum

¹⁰ It should be noted that the BWA spectrum licenses were granted after the publication of the national consultation document

As described above, given the coverage obligations the BWA licensees have agreed to, such networks will deploy ubiquitous networks well within the timeframe of this review. The MCA is aware that BWA networks are capable of providing packet-based voice services similar in functionality and price to those provided by the fixed incumbent and the cable network. Hence, even though the MCA does not have any definite information as to whether these operators will start providing telephony services during the timeframe of this review, it nonetheless believes that in view of the forward-looking aspect of the Market Review, such possible entry is real and hence it is appropriate that call origination over BWA networks should be included in the market definition.

02.7 Conclusion on relevant markets

Following the analysis and discussion presented above, the MCA found the following product markets in Malta:

1. Residential analogue, cable and broadband wireless access lines provided over fixed public electronic communications networks.
2. Non-residential analogue, cable and broadband wireless access lines provided over fixed public electronic communications networks.
3. Residential ISDN BRA access provided over fixed public electronic communications networks.
4. Non-residential ISDN BRA access provided over fixed public electronic communications networks.
5. Non-residential ISDN PRA access provided over fixed public electronic communications networks.

Chapter 03 - Market Analysis

Having identified the relevant markets as discussed in **Chapter 02** the MCA is required to analyse the markets in order to assess whether any undertaking has significant market power as defined in Regulation 8 of the ECNSR (Article 14 of the Framework Directive).

03.1 Method to Assess Significant Market Power

Under the Electronic Communications Directives and Article 4(8) of the ECRA, SMP has been newly defined so that it is equivalent to the competition law concept of dominance. Article 14(2) of the Framework Directive states that:

"An undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers."

Further, Article 14(3) of the Framework Directive states that:

"Where an undertaking has significant market power on a specific market, it may also be deemed to have significant market power on a closely related market, where the links between the two markets are such as to allow the market power held in one market to be leveraged into the other market, thereby strengthening the market power of the undertaking".

Therefore, in the relevant market, one or more undertakings may be designated as having SMP where that undertaking, or undertakings, enjoys a position of dominance. Also, an undertaking may be designated as having SMP where it could lever its market power from a closely related market into the relevant market, thereby strengthening its market power in the relevant market.

In assessing whether an undertaking has SMP, this review takes the utmost account of the Commission's SMP Guidelines as well as the MCA's equivalent guidelines, as referred to in Chapter 01 above.

03.2 Assessment of SMP Against Relevant Criteria

The remainder of this chapter considers whether single dominance is likely to exist in the identified markets. In the MCA's view the assessment is fully compliant with the Commission's Guidelines. The SMP assessment set out is based on the evidence available to the MCA.

Single dominance can be assessed using a large number of criteria, as described in the Commission's and the MCA's guidelines on SMP assessment. In the MCA's view, the most appropriate ones are:

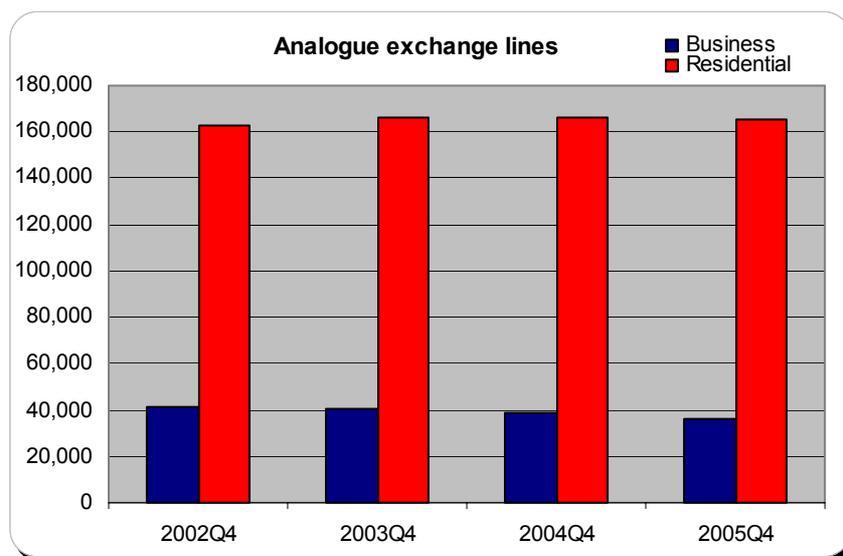
- Market share analysis
- Barriers to entry
 - ✓ Economies of scale and scope

- ✓ Sunk cost
- ✓ Vertical integration
- Potential competition
- Countervailing buyer power

3.2.1 Analysis of market shares

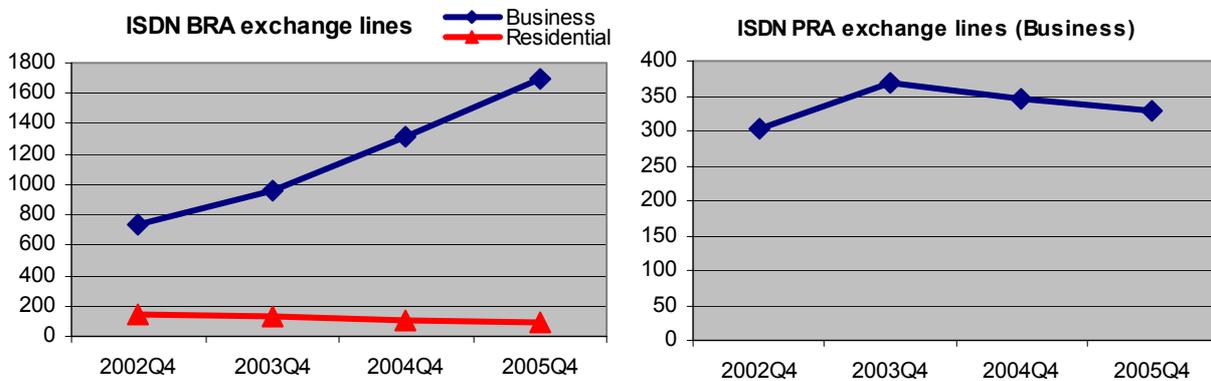
Although, high market shares are not in themselves decisive as to whether an undertaking enjoys SMP in a market, the MCA is of the opinion that market shares higher than 50 per cent would be indicative of SMP. Paragraph 75 of the Commission Guidelines states that, “according to established case-law, very large market shares – in excess of 50% - are in themselves, save in exceptional circumstances, evidence of the existence of dominant position.”

Maltacom is the main fixed line operator in Malta offering access line services to residential and non-residential customers. Maltacom provides all analogue and ISDN exchange lines in Malta, whilst Melita Cable provides all the cable access lines. The following illustrations provide information on the number of exchange lines that Maltacom currently provides.



The total number of analogue exchange lines over the past three years has remained very stable around 204,000. As stated earlier, the cable operator launched its cable access services in July 2005 and as at December 2005 had approximately 3700 subscribers. Since the Melita Cable has no interconnection agreements with other operators all cable subscribers still have the analogue exchange line provided by Maltacom. This is currently required to make calls to other Maltacom subscribers and mobile operators. However, when Melita Cable interconnects with Maltacom and mobile operators, cable subscribers can easily choose to maintain only one access line. Due to this development in the market the MCA expects that a number of subscribers would permanently switch to cable access from their current analogue exchange line. Nonetheless, the MCA does not expect that during the

timeframe of this review Maltacom would lose a significant amount of subscribers such that it will lose its SMP position in the provision of access lines. From figures available to the Authority, Maltacom currently has 98 per cent market share in the residential and non-residential analogue and cable access lines market, whereas Melita Cable has the remaining 2 per cent.



The illustrations above clearly show that the penetration of ISDN exchange lines in Malta is very limited. Over the past four years the total number of ISDN BRA exchange lines has increased by 50 per cent. The number of ISDN BRA lines acquired by business customers has doubled whilst that for residential customers has marginally decreased.

The level of penetration of ISDN PRA exchange lines is significantly low in Malta with an average of 335 lines during the past four years. Given the particular functionality and high prices of this product, all ISDN PRA connections are currently acquired by business customers.

Since Maltacom is the only provider of ISDN exchange lines, it has a 100 per cent market share when calculating both subscribers and revenues associated with these services.

The data presented above clearly indicates that Maltacom has significant market power in all the abovementioned access markets. The finding of dominance is further supported by the fact that Maltacom has an enduring high market share in these markets. Moreover, given the observed trends in these markets, the MCA is of the opinion that Maltacom will likely continue to enjoy SMP during the timeframe of this review.

3.2.2 Barriers to entry

Barriers to entry can take many forms such as significant sunk costs or economies of scale and scope resulting from the presence of a large undertaking in the market. The presence of entry barriers may create the necessary market conditions for an operator to exercise market power.

Economies of scale

For a significant number of years, Maltacom was the only operator providing fixed access and national call services to residential and non-residential customers in Malta. Given the ubiquity and the high density of this network Maltacom enjoys economies of scale in providing fixed access services. Given that Maltacom is currently providing the majority of

access lines in the market, the per line cost incurred by this undertaking for providing access services are likely to be much lower than those of a new entrant. A new entrant would need to take a large share of the market if it is to effectively compete with the incumbent. In order to gain a large market share the new entrant will have to price below the incumbent's prices, which would make it very difficult for this operator to cover its costs.

Given the size of Maltacom, it will be difficult for any other operator to provide access services below the price charged by Maltacom unless it is more efficient in its operations or uses more cost-effective technologies.

Another important area where economies of scale are likely to be achieved is in the supply of associated support services. Since Maltacom provides the majority of access lines in the market, its per line cost of providing associated services, like billing and customer care would be much lower than the cost of a new entrant.

Economies of scope

Economies of scope exist where average costs for one product are lower as a result of it being produced jointly with another product by the same firm. Cost savings may be made where common processes are used in the provision of a group of services. When an operator is present in a large number of markets it can share common costs over a greater range of services.

Maltacom is the fixed telephony incumbent and is therefore present in a large number of electronic communications markets providing a full range of services over its ubiquitous network, such as leased lines, international gateway, and calls. The ability to benefit from economies of scope may act as a barrier to entry for new competitors. For a new entrant to enjoy such economies of scope it would need to enter a large number of markets simultaneously, which would firstly increase the entry costs and secondly would make it more difficult to recoup such cost on exit.

The ability of Maltacom to benefit from such economies of scope are an indication that significant barriers to entry exist in the access markets, and suggest that Maltacom is likely to enjoy a lasting position of SMP in these markets.

Sunk costs

Sunk costs are those costs that a new entrant must incur to enter the market but which are not recovered on exit. A potential entrant will only seek to incur these costs if its expected return from such an investment would be sufficient to cover these costs. The incumbent on the other hand has already made its investment and would therefore be in a much better position to compete with the new entrant since it would already have covered its sunk costs. This asymmetry would make it very difficult for a new entrant to effectively compete with the incumbent.

Entering the access markets requires a large upfront investment resulting in significant sunk costs, which are not recoverable on market exit. The presence of such significant costs would indicate that there is little possibility for any new entrant to replicate the network of the incumbent and the cable operator during the timeframe of this review. Consequently, Maltacom would likely continue to benefit from SMP in these markets.

Vertical Integration

Vertical integration involves an undertaking operating in a given market, while also being present in a market that is at a higher or lower level in the chain of provision. Since vertically integrated operators are able to influence both upstream and downstream markets it would be more difficult for a new provider entering in one of these markets to compete effectively with the integrated operator.

Maltacom is an integrated provider and operates at a wholesale and retail level in all the electronic communications market where it is present. The ability to lever market power from upstream to downstream markets may deter potential entry in these markets. An integrated provider can make it difficult for new entrants at a retail level to obtain the necessary inputs at a competitive price (i.e. cost based) and therefore create an entry barrier at the retail level. Where Maltacom enjoys SMP at a wholesale level it can take the opportunity to lever its power in the downstream market in absence of regulation or effective competition.

3.2.3 Potential Competition

Potential competition refers to the prospect of new undertakings entering the market within a short period of time and therefore constrain incumbent firms. The potential entry may prevent firms from raising prices above competitive levels, leading thereby to situation in which no market power can be profitably exercised.

A realistic potential competitive constraint on Maltacom can come from the recent entry in the access market of the cable operator. As stated earlier in July 2005 the cable operator started offering cable access for the provision of IP-based telephony services which enables its customers to make on-net calls and international calls. The MCA is of the opinion that when the cable operator interconnects with other local operators, its cable access service will compete with the traditional analogue exchange line service offered by Maltacom. However, until the cable operator interconnects with other local operators, customers using the cable access service would not be in a position to have only one telephone line connection (i.e. cable or analogue) since customers wanting to call a PSTN or mobile number would still need access to the Maltacom network. The MCA is therefore of the opinion that until the cable operator interconnects with other local operators, the cable access service would not be in a position to compete at par with the incumbent's analogue exchange line service and therefore customers would not have a fully substitutable service. The MCA considers that this limitation will not allow the cable operator to successfully exert a significant competitive constraint on Maltacom in the provision access lines services for the time being.

Another potential development in the market will be the introduction of access services over BWA networks. On the 12th October 2005 the MCA allocated frequency spectrum to three undertakings for the deployment of a national BWA network. BWA network operators could potentially start providing access services over their wireless networks. However, the MCA considers that such a development would not have a material impact during the timeframe of this review since the rollout of a nation wide BWA network would be a lengthy and extensive process.

The MCA positively expects that the introduction access services over different fixed electronic communications networks is likely to increase the level of competition in the access markets in the near future. However, the MCA considers that during the timeframe of this review such a development would not be sufficiently widespread so as to erode the significant market power held by Maltacom. Nonetheless, the MCA is going to monitor closely the development of competition in the fixed access markets and will consider revising its conclusions if the market structure changes considerably.

3.2.4 Countervailing buyer power

The existence of customers with a strong negotiating position, which could be exercised to produce a significant impact on competition, will tend to restrict the ability of providers to act independently of their customers. When buyers of a certain product or service are large and powerful, they can effectively stop an attempt to increase prices by service providers.

The extent of countervailing buyer power depends on the ability of large customers to switch to alternative providers or not to purchase the service or product from that particular provider within a short period of time.

Currently, residential customers have no alternative provider to Maltacom for acquiring access services that allow them to have ubiquitous connectivity to all networks. Small businesses, which account for a very large portion of total businesses in Malta¹¹, do not have sufficient bargaining power with Maltacom. On the other hand, only a handful of large companies (such as banks and large corporations), which purchase a full range of services from this undertaking, might exert to a very limited extent some countervailing buyer power. However this is not considered to be sufficient to constrain Maltacom to a significant degree.

Notwithstanding, the MCA is of the opinion that in absence of alternative providers offering ubiquitous services it is not possible for a particular customer or group of customers to exert sufficient countervailing buyer power on Maltacom to pose a serious price constrain on its operations in absence of regulation.

03.3 Summary of responses to the National Consultation and MCA replies to issues related to the market analysis

One respondent argued that although the MCA identified 5 separate markets these were analysed collectively. According to the respondent, this approach limits transparency and lacks identification of specific market characteristics which in turn leads to a common set of remedies.

The MCA does not agree with the interpretation given by the respondent. Where feasible, the Authority, undertook an individual analysis for the markets whilst in other instances an individual analysis would have produced the same result as a collective analysis. In its market shares analysis the MCA undertook an individual analysis since differences in markets warranted such an approach. Other criteria such as barriers to entry and vertical integration were analysed collectively since Maltacom provides all these services on its network and therefore faces similar conditions in providing all services. A separate analysis for each individual market would have lead to the same conclusions as a collective analysis.

Market shares

A respondent argued that the MCA did not substantiate its claim that given the lack of interconnection agreements, the access product of Melita Cable does not pose a sufficient competitive constraint on Maltacom. The respondent argued that the increase in the number of cable IP-telephony services customers shows otherwise. The respondent put further

¹¹ According to estimates from the National Statistics Office out of 31,657 business units, 29,883 units are classified as micro units (0-9 employees) and 975 units are small units (10-49 employees). Therefore 97 per cent of all businesses in Malta are micro or small enterprises employing less than 49 employees.

emphasis on Melita's ubiquitous network and that 80% of households have a cable TV connection and another 50% have a cable broadband connection. This, the respondent stated, shows that there is clear evidence that there is increased pressure on Maltacom.

The MCA maintains its position that until Melita has negotiated interconnection agreements with other network operators which would enable its customers to make calls to any network, customers cannot switch to the Melita Cable access product and forgo the use of Maltacom's access product. Therefore the current limited substitutability between these services limits significantly the pressure that Maltacom faces from Melita Cable.

The MCA is however cognisant that Melita Cable will soon have interconnection agreements with the major voice telephony operators and will therefore start offering a ubiquitous service. When such agreements are negotiated Melita Cable will then be able to exert pressure on Maltacom since consumers would have a feasible alternative to Maltacom's product. Nevertheless, the fact that Melita Cable will be a direct competitor to Maltacom does not necessarily imply that Maltacom will lose its SMP in the access market. The emergence of a competitor means that competition is starting to emerge in a market but not that effective competition is achieved from day one. Maltacom will face a constraint not to increase prices and to provide better services. In order for Melita Cable to erode Maltacom's market power, it would need to attract a large number of customers to its network such that it would diminish the high market share enjoyed by the fixed incumbent.

The MCA is of the opinion that this situation will be very difficult to be observed with the two year timeframe of this review. Nevertheless, the Authority will keep a close watch on the developments in this market and will consider revising its conclusions if warranted.

The same respondent further argued that our analysis of market shares is backward-looking, static and incomplete and does not reflect the dynamic state in which this market is evolving.

The data provided in the consultation document is based on data provided by the operators (including the respondent) available up to September 2005, i.e. two weeks prior the publication of the consultation document. The MCA cannot understand the allegation made by the respondent that the data is incomplete and static. The MCA is now in a position to update the data up to December 2005 which should provide even a better picture of the market. Data as at end December 2005 shows that Maltacom had the absolute majority of fixed access lines in Malta with a 98% market share, whilst Melita Cable had only a 2% market share.

Barriers to entry

One respondent argued that in its market analysis assessment the MCA completely ignores the fact that there is *"another network that enjoys ubiquity and economies of scale and scope"* and that with interconnection agreements in place it will provide a direct competitive pressure on Maltacom.

The MCA does not dispute the fact that Melita Cable has a ubiquitous network. Neither it disputes that following the setting up of interconnection agreements with other public voice telephone networks Melita Cable would be in a position to compete at par with Maltacom. However, assuming that interconnection agreements are achieved by the end of this year, the MCA is doubtful as to how can the cable operator easily erode the market share of Maltacom over the next two years.

A respondent suggested that the number of access lines over Maltacom's network is not so high such that a new entrant would find it difficult to gain enough market share in order to achieve similar economies of scale and scope. The respondent argues that the economies of

scale and scope that Maltacom enjoys are by far smaller than other EU incumbents such as the Irish incumbent eircom which has 2 million access lines. The respondent concludes that size of Malta limits the potential gains of economies of scale and scope compared to other countries.

The MCA does not in principle agree with these kind of comparisons. The respondent based his conclusion on just one statistic by mentioning the number of access lines of Maltacom and comparing them in absolute terms with those of the Irish incumbent. The capital and operational cost associated with operating a network covering the national territory of Ireland are presumed to be significantly higher than that of Maltacom to cover the Maltese territory¹². The MCA would like to point out that economies of scale are not only related to absolute size but also to network utilisation and efficiency in operations. Furthermore, the MCA considers that during the timeframe of this review it will be very difficult for any new entrant in the market to gain a large portion of the 200,000 plus access lines of Maltacom.

The same respondent argued that due to technological developments new entrants, in particular BWA operators, will find it less difficult to compete with Maltacom by using cheaper IP technology, and therefore any economies of scale and scope enjoyed by Maltacom would be easily achieved by new entrants.

The MCA is cognisant of the emergence of packet-based technology and the efficiency gains of providing services over NGN infrastructures. The MCA however has strong reservations that BWA entrants will be in a position to achieve economies of scale and scope so quickly such that they will be able to compete with Maltacom at an early stage of their launch. In fact as the same respondent correctly states in the response, two BWA networks will only be able to cover 50% by the end of this year and 90% by the end of 2007. This implies that customers would not be able to substitute the service of Maltacom with the BWA providers prior end 2007 since BWA operators would not be able to offer their clients a ubiquitous service. This would greatly limit the take up of a hypothetical telephony service provided by BWA providers.

The Cable operator has already a packet-based network infrastructure and therefore it can reap the benefits of this technology. However, Melita Cable does not have the subscriber base for telephony services of Maltacom that would enable it to enjoy economies of scale. The fact that new entrants use packet-based technology does not mean that new entrants automatically face the same economies of scale as the existing operator that has a high market share. Economies of scale are gained over time subject to volumes and efficient utilisation of infrastructure.

Notwithstanding the above, the MCA positively notes that Maltacom is also upgrading its own network to an packet-based based infrastructure which would result in significant efficiency gains in the provision of services. The MCA therefore considers that Maltacom would be able to compete and reap the benefits of improved technology exactly as the new entrants. Maltacom would be in a position to counteract any aggressive competition by competitors which deploy an packet-based networks and can therefore maintain its high market share. With its already existing large customer base, Maltacom would still be at an advantage over its competitors since it can start exploiting economies of scale associated with packet-based technology from the start. The new entrants would need to build their customer base, a process which would take time and would not likely happen during the time frame of this review.

¹² 27km by 15km

A respondent said that the convergence of services and the fact that existing network operators are present in different markets, there exists a high potential for operators to offer bundles of products and therefore leverage their market position from one market to another. The potential for offering triple play over different networks is high.

The MCA is fully aware of the potential that in the near future triple play would be provided over different fixed electronic communications networks. Bundles of products would be offered by operators in order to retain/attract customers and enable them to have one-stop-shop solutions for the purchasing of their electronic communications services. Maltacom as the fixed incumbent owning a fixed and mobile network and also having a DTTV licence can strongly and effectively compete with any new entrant offering triple play products, given that Maltacom's current subscriber base is nearly 100%. Maltacom is also present in almost all markets for electronic communications service. Furthermore, Maltacom is the only provider in Malta currently in a position to offer quadruple play – since it is able to offer fixed and mobile telephony, broadband and also digital broadcasting services to its subscribers. The potential for new entrants to resort to leveraging tactics can effectively be replicated by Maltacom in order to retain its large customer base.

Sunk cost and vertical integration

One respondent argued that the consultation document fails to identify that the cable network operator, similarly to Maltacom, has already covered its sunk costs given that it has been present in the market of a significant number of years. Moreover, the cable network operator is also a vertically integrated operator as Maltacom. According to the respondent, the MCA is overestimating the difficulty for the new BWA operators to start competing with Maltacom. The respondent argued that the over demand for BWA licences, the small territory of Malta and the fact that BWA operators will not have to have capillary cable-laying support this view.

The MCA agrees that Melita Cable has been providing cable TV services and broadband services for a number of years over its cable network and it is likely that it has covered its sunk cost. Moreover, Melita Cable is also a vertically integrated operator as Maltacom. In this respect one of the new entrants in this market has a similar position to Maltacom.

However the fact that Melita Cable is a vertically integrated operator and that it has covered its sunk costs does not imply that Melita Cable has SMP or that Maltacom has no SMP but rather that Melita Cable can compete more favourable than other new entrants which are not vertically integrated operators or that need to deploy a new network, such as the 3 BWA network operators.

The MCA agrees with the respondent that the roll-out of BWA will not require an extensive laying of cabling such as that of Maltacom or Melita Cable, however the Authority considers that the deployment of BWA networks requires a significant investment and commitment. The fact that the deployment of a national network requires as a minimum two years is in itself a good indicator of the magnitude of the investment required. The MCA believes that new entrants would need to incur a significant amount of sunk cost to deploy a national BWA network.

Potential Competition

One respondent argued that the cable operator will very soon conclude interconnection agreements with all public voice telephony networks, therefore competitive pressures would soon be presented on Maltacom. This would limit the ability of Maltacom to act independently from its customers since this would translate in a significant loss of market share. Moreover, the respondent argued that BWA will start offering access services for the purpose of voice telephony services during the timeframe of this review and would increase further the competitive pressures on Maltacom.

The MCA is aware of the negotiations underway by Melita Cable for interconnection with other operators and is of the opinion that once these agreements are concluded the cable operator would be able to have a fully substitutable service to compete with Maltacom. As the respondent implied, the competitive pressures on Maltacom would be mainly on price setting, since Melita is presumed to start competing aggressively on price to attract customers over its network from Maltacom.

The respondent argues the BWA operators will also successfully exert significant competitive pressure on Maltacom. The Authority notes that BWA operators will only have a fully fledged network during the last quarter of 2007 which would be very near to the end of this review period. The MCA considers that the limited coverage of BWA networks is a very limiting factor for attracting consumers. As a result, the Authority is convinced that during the timeframe of this review BWA operators would not have a significant constraining effect on Maltacom.

Given these recent developments in the access markets, the MCA has assessed in detail the constraint that Melita cable and potentially BWA operators will pose on Maltacom price setting behaviour for national access services. In its assessment the MCA took into consideration the fact that Melita Cable already has a ubiquitous network and can therefore start competing aggressively possibly by the end of this year. As a result, the MCA considers that with respect to price setting behaviour, Maltacom can be constrained since an increase in price would result in consumers shifting to the cable access product. The Authority therefore considers that market forces will pose an efficient price cap on the prices charged by Maltacom. The MCA is therefore taking into account this scenario and is revising its proposed set of remedies outlined in the National Consultation document particularly on the application of a price-cap model.

Notwithstanding the above, the MCA cannot at this point safely conclude that this market presents evidence of an effectively competitive market. Evidence clearly shows that currently Maltacom has 98% of subscribers connected to its network whilst the cable operator has only 2% market share amongst other factors. Given the high market share of Maltacom it would be very difficult for Melita Cable to erode such a market share during the timeframe of this review.

Countervailing buyer power

One respondent argued that customers will soon have an alternative to Maltacom's fixed access services once Melita Cable manage to interconnect with other networks. Moreover, the respondent argued that business customers cannot be considered as small customers due to the number of employees they employ. There are small companies in terms of number of employees but are relatively big customers of electronic communications services.

The respondent further states that Melita Cable has an existing large customer base for its cable TV and broadband services. Therefore, if Maltacom were to increase its prices of its access services it would not be difficult for these customers to switch to Melita Cable for access and telephony services.

As stated above the MCA is cognisant that Melita Cable will likely to have interconnection agreements in place by the end of the year. The potential for consumers to move to Melita Cable access product would pose a constraint on Maltacom from increasing its retail prices of access services. As said above the MCA is factoring this development in its decision on remedies discussed below.

03.4 Conclusion and SMP designations

The evidence presented above clearly suggests that Maltacom enjoys significant market power in all of the access markets identified earlier on.

This conclusion is supported by the fact that Maltacom has a 100 per cent market share in the provision of ISDN exchange lines and 99 per cent market share in the analogue and cable access market. The company is also a vertically integrated provider supplying a full range of electronic communications services at wholesale and retail level. This puts Maltacom in a favourable position to leverage market power (where it holds such power) from upstream to downstream markets. The presence of high barriers to entry in the access markets makes it very difficult for new entrants to introduce an element of competition in these markets in the absence of regulation.

Consequently, the MCA concludes that Maltacom has significant market power in the following relevant markets:

1. Residential analogue and cable access lines provided over fixed public electronic communications networks.
2. Residential ISDN BRA access provided over fixed public electronic communications networks.
3. Non-residential analogue and cable access lines provided over fixed public electronic communications networks.
4. Non-residential ISDN BRA access provided over fixed public electronic communications networks.
5. Non-residential ISDN PRA access provided over fixed public electronic communications networks.

Chapter 04 – Regulatory Implications

As evidenced above, this market review has defined five relevant markets in Malta with respect to access to public telephone networks at a fixed location. Pursuant to an analysis of the market characteristics of all the said markets, the MCA has concluded that Maltacom has SMP in all the said markets.

In accordance with Regulation 10(4) of the ECNSR, where an operator is designated as having significant market power on a relevant market in accordance with Regulation 8 of the same ECNSR the MCA is obliged to impose on such operator such appropriate specific regulatory obligations referred to in subregulation (2) of regulation 10 of the ECNSR or to maintain or amend such obligations where they already exist.

This section thus aims at highlighting the actual and potential competition problems that exist in the defined markets, and the adequate remedies to be imposed on Maltacom in order to address these problems.

04.1 Competition Problems

The MCA has identified three broad categories of existing and potential competition problems that arise due to the SMP enjoyed in the identified fixed access market.

4.1.1 Vertical Leveraging

Vertical leveraging is any dominant firm's practice to deny proper access to an essential input it produces to some users of this input, with the intent of extending monopoly power from one segment of the market (the bottleneck segment) to the other (the potentially competitive segment).

Maltacom, as a vertically integrated operator dominant in an upstream market may engage in pricing that gives rise to a margin squeeze. Furthermore, since it is able to access economies of scale and scope that are not so readily available to potential operators competing at the downstream level, may bring extra pressure to bear on the margins available for competing downstream operators. Maltacom may also resort to other price leveraging strategies such as price discrimination, predatory pricing and cross-subsidisation. Currently the charges which Maltacom may apply are regulated at a retail level and this has mitigated to a certain extent the aforementioned competition problems.

4.1.2 Horizontal Leveraging

Horizontal leveraging involves the dominant undertaking using its position in one market to exert undue influence on other markets.

The MCA identifies two major potential competition problems in this respect. Firstly, Maltacom could use its dominance attempt to drive its competitors out of the market by setting a price below costs in potentially competitive markets, while the losses are covered by profits from another market. Secondly, with particular reference to the *easyline* telephone service from Maltacom, a potential horizontal leveraging problem could occur with the

bundling or tying of access services with calls. Because this bundle cannot generally be replicated by most alternative operators, competitive concerns arise.¹³

4.1.3 Entry deterrence, exploitative behaviour and productive inefficiencies

Besides the leveraging issues discussed above, the MCA believes that the single market dominance enjoyed by Maltacom in the relevant markets concerned gives rise to a number of competition problems relating to entry deterrence, possible exploitative behaviour and productive inefficiencies.

The MCA notes that currently Maltacom's market share in retail access markets is of one hundred percent. Given the ubiquity and the high density of its network, Maltacom enjoys economies of scale in the provision of access services. Because Maltacom currently provides all access lines in the market, the cost of providing a line is likely to be much lower than those of a potential new entrant. These economies may act as a barrier to entry.

Exploitative behaviour could take the form of measures taken to increase switching costs, exclusive dealing and predatory, excessive or discriminatory pricing. As stated above, the MCA has intervened on a number of occasions to curtail as much as possible these competition problems. At present Maltacom's access charges have to be cost-oriented, transparent and non-discriminatory.

04.2 Available Remedies

As mentioned above, MCA is obliged by the ECRA to impose an obligation on undertakings with SMP. The MCA also has the obligation under Article 9(3) of the ECRA and regulation 10(4) of the ECNSR to act in pursuit of its statutory obligations to ensure adequate access, interconnection and interoperability of services without prejudice to any measures which may be imposed on undertakings designated as SMP operators and subject to obligations listed in regulations 18 to 22 of the ECNSR (Wholesale obligations) and regulations 37 to 39 of the ECNSR (Retail obligations) as detailed below.

- Obligation of Transparency
- Obligation of Non-discrimination
- Obligation of Accounting Separation
- Obligation of access to, and use of, specific network facilities
- Price control and Cost Accounting obligations
- Leased lines and Carrier Selection and Pre-Selection

04.3 Selecting Remedies – Principles Applied

In accordance with regulation 37(2) of the ECNSR, the MCA is obliged to ensure that any obligations imposed under subregulation (1) of the same regulation 37 shall be based on the nature of the problem identified and be proportionate and justified in the light of the objectives laid down in Article 4 of the Electronic Communications Regulation Act.

¹³ ERG, Common position on the approach to appropriate remedies in the new regulatory framework ERG (03) 30rev1 pg,36

In view of the identified actual and potential competition problems arising from SMP in the market relating to retail access to the public telephone network at a fixed location, the MCA is obliged to impose obligations on undertakings identified by it as having significant power on that market. As mentioned earlier, the MCA believes it unlikely that within the period of this review there will be any development of effective competition in the identified markets relating to retail access to the public telephone network at a fixed location. Accordingly, the MCA is imposing on the SMP operator those appropriate obligations that it believes will encourage efficient investment and innovation and further promote competition in the markets relating to the relevant markets under review.

In selecting the remedies to impose on the designated SMP operator the MCA has considered the nature of the problem identified and, in accordance with the principle of proportionality, will impose a range of remedies which are considered to be the least burdensome effective remedies. The MCA has also taken account of potential effects on any related markets

Finally, the MCA has done its utmost to ensure that the remedies chosen will be incentive compatible. This means that the MCA has selected and designed the remedies to be imposed in a manner that ensures that compliance with the remedy by the undertaking identified as having SMP outweighs the benefits of evasion.

It is unlikely that any single remedy can achieve this, so the remedies outlined below should be seen as a complementary suite which support and reinforce each other.

04.4 Regulatory Obligations

The MCA is of the opinion that the obligations it is imposing are based on the nature of the competition problems it has identified in the relevant markets, and are proportionate and justified in light of the objectives set out in Article 4 of the Electronic Communications (Regulation) Act.

The MCA will however continue to monitor market developments and where appropriate shall issue directions to further fine-tune these remedies to the needs of the market and, where the desired levels of competition in the market are deemed to have been reached, the MCA shall consider lessening the burden of the obligations and even withdrawing them altogether.

4.4.1 Access to Wholesale Inputs

In the previous sections the MCA concluded that the access markets are not competitive and the replication of the networks owned by Maltacom and Melita Cable is difficult to occur during the timeframe of this review. Therefore, in order to bring the benefits of competition to the end-user, and to reduce market failures associated with foreclosure of the retail market, it is essential that competing operators can gain access to Maltacom's access infrastructure. This implies that remedies should be imposed in order to provide alternative operators with sufficient access to wholesale inputs, so that access and calls services may be offered over the existing infrastructure.

4.4.2 Carrier Selection and Pre-Selection

Regulation 39 of the Electronic Communications Networks and Services (General) Regulations requires that where as a result of a market analysis, a relevant market consisting of the provision of connection to and use of the public telephone network at a fixed location is

not effectively competitive, the Authority is obliged to impose Carrier Selection by means of a Carrier Selection code and Carrier Pre-Selection. The provision of these facilities shall carry cost oriented pricing for access and interconnection. In addition, their direct charges to subscribers should not act as a disincentive to the use of such facilities.

Given the finding that Maltacom has significant market power in the relevant markets consisting of the provision of connection to and use of the public telephone network at a fixed location, Maltacom is obliged to continue to provide Carrier Selection and Carrier Pre-selection. The facilities shall be provided in respect of all access lines identified in the relevant markets. In order to complement this obligation, the MCA is also proposing a number of other obligations which include non-discrimination, transparency, price and cost accounting, and accounting separation. Full details of these obligations are found in the market review on 'Retail National Telephone Services provided at a Fixed Location'¹⁴.

4.4.3 Wholesale Line Rental

As discussed earlier, a significant impediment to the emergence of sustainable competition and the objectives set out in Article 4 of the Electronic Communications (Regulation) Act is the considerable difficulty to replicate fixed networks during the timeframe of this review.

In order to facilitate the emergence of sustainable competition in the access markets and encourage alternative operators to enter the market, the MCA is of the view that Maltacom should be directed to provide a solution whereby carrier pre-select operators are able to provide a single bill to their customers for access and calls, irrespective of the fact that such access may be provided to the customers by Maltacom. This facility would be available in respect of customers using carrier pre-selection for all calls with the same carrier pre-select operator, and may take the form of a wholesale line rental solution or any other similar single billing solution. Such a combined product would enable carrier pre-select operators to offer a single product to their customers for the services they provide.

The imposition of such remedy has therefore two objectives. The first objective is to address directly Maltacom's significant market power in the access markets by enabling competing providers to compete in retail access markets without building direct access networks. The second objective is to enhance the effectiveness of the Carrier Selection and Carrier Pre-Selection obligations in the provision of telephone services.

Supporting remedies covering access, transparency, non-discrimination, and price control and cost accounting would need to be applied to address the relationship between Maltacom and the alternative operators.

In order to facilitate entry in the access markets and foster competition, the MCA considers it appropriate to impose access requirements in accordance with Regulation 21 of the Electronic Communications Networks and Services (General) Regulations.

4.4.4 Non-discrimination

Where an SMP operator, like Maltacom, is also a vertically integrated provider, there may be an incentive to provide wholesale services on terms and conditions that discriminate in favour of their own retail activities in such a way as to have a material effect on competition. In particular, there are incentives to charge more competing providers for wholesale services than the amount charged to their own retail activities, thereby increasing the costs of

¹⁴ Link to website www.mca.org.mt

competing providers and giving themselves an unfair competitive advantage. Besides tackling price-related competition problems, non-discrimination can directly target non-price parameters such as withholding of information, delaying tactics, undue requirements, low or discriminatory quality, strategic design of products, and discriminatory use of information - conditions which would disadvantage competing providers and in turn consumers.

As a result of the wholesale line rental or other single billing solution, access lines currently provided by Maltacom will start to be used by alternative operators to provide a service to the customer which is equivalent to the access provided directly by Maltacom. The MCA believes that an obligation of non-discrimination, as a remedy under Regulation 19, provides the same ability to alternative operators to purchase wholesale access to retail lines as would apply to Maltacom's own retail access arm. Moreover, the information and services related to the wholesale line rental or single billing product to be provided to alternative operators should be similar to those provided to its downstream retail service provider. In particular, it is important that information gained by Maltacom as a result of its provision of services to another operator is not used by its downstream activities in any manner to obtain any unfair advantage.

4.4.5 Transparency

In order to ensure compliance with and monitor the non-discrimination obligation set on Maltacom, the MCA considers it is necessary to apply transparency as a supplementary obligation.

The MCA believes that it would be proportionate and justified to impose a transparency obligation on Maltacom to demonstrate that the incumbent delivers services of equivalent quality to other operators and its own retail activities. The imposition of such remedy ensures that alternative operators have sufficient information and clear processes to which they would not otherwise have access. This would assist their entry into the market and directly targets the nature of such problems.

Regulation 18 of the Electronic Communications Networks and Services (General) Regulations empowers the Authority to impose transparency obligations on undertakings holding significant market power 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.

Moreover, in particular where an operator has obligations of non-discrimination, the Authority may, require that operator which has significant market power 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. In such instances, the Authority is able to impose changes to reference offers to give effect to the obligations imposed under the Act. The Authority may also specify the precise information to be made available, the level of detail required and the manner of publication.

Currently Maltacom publishes, as part of its Reference Interconnection Offer, pricing in relation to Carrier Selection and Pre-Selection but not Wholesale Line Rental or any similar single billing solution. Under the obligation of transparency that the MCA is imposing, Maltacom is obliged to publish a reference offer related to Wholesale Line Rental or any other single billing solution that may be adopted. Such an offer is to be sufficiently unbundled, include pricing, terms and conditions and service level agreements, in any case as directed by the MCA. The level of detail and the manner of publication will continue to be

tackled further through consultative process. The implementation of this obligation may also require the publication of other information from time to time.

Any new offerings developed pursuant to Regulations 19, 21 and 39 should also be detailed in a reference offer. Maltacom is therefore directed to submit for the MCA's approval a reference offer within 30 calendar days of the publication of this decision. During this period other undertakings may commence negotiations with Maltacom for the provision of such wholesale line rental or similar single billing solution. Any commercially agreed solutions would remain applicable on a provisional basis until the MCA approves Maltacom's proposed reference offer.

4.4.6 Price control and cost accounting

Regulation 22 of the Electronic Communications Networks and Services (General) Regulations authorises the imposition of obligations relating to cost recovery and price controls, including obligations for cost orientation of prices and obligations concerning cost accounting systems, for the provision of specific types of interconnection and, or access.

Such intervention in pricing can be used to move the market from a situation of monopoly to one this is effectively competitive and at the same time to support the obligations of non-discrimination and transparency.

In competitive markets, the price of services is driven down to competitive levels by the commercial judgement of the undertakings forming the market. However, where competition does not provide pricing constraints, it is necessary to prevent excessive pricing by means of regulation. Without some intervention in pricing, dominant providers are likely to charge excessive prices, in order to maximise both their profits and the costs of competing providers. Higher wholesale charges are likely to mean higher retail prices and alternative operators being less able to compete in the retail market at the detriment of end-users.

Pricing Methodologies

The MCA has concluded that Maltacom's dominance in the retail access market is unlikely to be eliminated over the timeframe of this review. It has therefore concluded that Maltacom should be directed to provide a wholesale line rental or single billing solution and to provide Carrier Selection and Pre-Selection. As discussed above, a vertically integrated operator with market power in the wholesale markets, absent regulation of wholesale products, could be able to exert its market power by charging an excessive price for wholesale inputs and could be able to foreclose the retail market by means of a margin squeeze. Consequently, and as a result of the obligations of non-discrimination and transparency, the MCA concludes that the Carrier Selection and Pre-Selection as well as the wholesale line rental or single billing solution should be governed by virtue of the provisions set out in Regulation 22. The specifics of such obligation will be dealt with through a public consultative process which will then be notified to the European Commission in accordance with Regulation 6 of ECNSR (Article 7 of the Framework Directive).

Cost accounting systems

The MCA concluded that the Carrier Selection and Pre-Selection as well as the wholesale line rental or other single billing solution, should be governed by virtue the provisions set in Regulation 22. The Authority believes that a cost accounting system will be necessary to support such an obligation and is therefore imposing this as a further obligation on Maltacom.

The MCA is of the view that if it does not impose such an obligation, Maltacom could maintain some or all of its prices at an excessively high level, or impose a margin squeeze so as to have adverse consequences on competing operators and end-users. If the MCA were

to relax this obligation, it would not have the necessary means of ensuring price controls in the market and prevent potential market failures.

The MCA does not consider this obligation will constitute an unreasonable burden on Maltacom given that the undertaking is already under the obligation to support such a system by virtue of a previous MCA decision¹⁵ and that this has already been in place for some time.

The MCA is therefore maintaining the existing level of cost accounting system obligation on Maltacom, to be also applicable for the wholesale line rental or single billing solution, until such time that any amendments are deemed necessary.

4.4.7 Accounting separation

Part of the effectiveness of the non-discrimination obligation is reliant on the introduction of the obligation of accounting separation to facilitate the verification of compliance that Maltacom is providing services to other operators under the same pricing conditions as provided for its downstream arms.

Separated accounts help disclose market failures and provide evidence in relevant markets of the presence or absence of discrimination and margin squeeze. Such obligation support the imposition of transparency as it makes visible the wholesale prices and internal transfer prices of an operator's products and services. It also allows the MCA to check compliance with obligations of non-discrimination and to address the price competition problems. The MCA considers that the effectiveness of the transparency and non-discrimination obligations is reliant on the introduction of the obligation of accounting separation to facilitate the verification of compliance.

The MCA is therefore directing Maltacom to include the wholesale line rental or single billing solution as part of the existing accounting separation model as identified under its decision on Accounting Separation¹⁶. Maltacom is to provide detailed separated accounts as direct by the MCA.

The MCA believes that if it were to withdraw this obligation, it would not have any means of monitoring non-discrimination, transparency or of having any information on margins in the retail business.

Retail Remedies

Until an operator is identified as having SMP in a particular relevant market following a market analysis procedure, Article 40 of the Electronic Communications (Regulation) Act requires undertakings to continue to comply with former obligations. Regulation 30 of the Telecommunications Services (General) Regulations of 2000 required a dominant operator providing fixed telephony services:

- to use cost oriented-tariffs;

¹⁵ Implementation of Cost Based Accounting Systems for the Telecommunications Sector - Report on Consultation and Decision - July 2002

¹⁶ Accounting Separation and Publication of Financial Information for Telecommunications Operators - Report on Consultation and Decision of October 2002.

- not to bundle services into a single tariff without also offering each of the constituent services under separate tariffs;
- to publish its tariff charges.

The Authority was also entitled to define and impose a price control cap formula, geographical averaging or other price regulation schemes for services that are provided in markets which lack effective competition. Moreover, tariffs were to be transparent and non-discriminatory.

At present the main retail control in place that prevents excessive pricing in the retail market in Malta is the obligation of cost-orientation. In comparison with a price cap mechanism (which addresses the upper limit of pricing for a basket of services), cost-orientation is a more general obligation that can prevent an operator in a dominant position from charging excessive prices for specific services. Cost-orientation also helps to ensure that such an operator does not attempt to restrict market entry by charging unreasonably low prices.

Under the new electronic communications framework, where a market analysis leads to a determination of an operator as having SMP status in a particular retail market and the Authority concludes that obligations imposed under Part III or Regulation 39 would not result in the achievement of the objectives set out in Article 4 of the Act, the Authority shall impose obligations to ensure that the undertaking concerned does not:

- charge excessive pricing,
- inhibit market entry or restrict competition by setting predatory prices,
- show undue preference to specific end-users, or
- unreasonably bundle services.

In order to counter these problems and protect end-user interests whilst promoting effective competition, Regulation 37(3) enables the Authority to impose:

- appropriate retail price cap measures
- measures to control individual tariffs, or
- measures to orient tariffs toward costs or prices on comparable markets

On the basis of what has been stated earlier in this document, the MCA deems that the imposition of the above-mentioned wholesale remedies is necessary in order to achieve the desired level of effective competition in the retail access markets. This notwithstanding, the MCA feels that the wholesale remedies imposed on Maltacom will not, by themselves, suffice to bring about the objectives set out in Article 4 of the ECRA mainly due to the uncertainty of the impact that the wholesale remedies will have in rendering the market effectively competitive. The MCA feels that, unless the said wholesale remedies are further supplemented by the retail measures being imposed below the objectives set out in Article 4 of the ECRA will not be fulfilled.

The MCA considers that the market requires the imposition of retail remedies, mentioned in Regulation 37 of the ECNSR as explained below. Having said this, the MCA will however continue to constantly monitor market developments. Where it deems appropriate, the MCA shall issue directions to further fine-tune the remedies to the needs of the market and, where the desired levels of competition in the market are deemed to have been reached, the MCA shall consider lessening the burden of the obligations and even withdrawing them altogether.

4.4.8 Measures to counter the charging of excessive pricing and countering measures that inhibit market entry or restrict competition

Cost Orientation for Retail Prices

As mentioned above, there is currently also a general obligation of cost-orientation for retail fixed voice telephony services, with respect to the operator holding a dominant position. This obligation ensures that the said operator does not charge excessive prices for specific services, nor does it attempt to restrict market entry by charging unreasonably low prices or unfairly squeezing the margins of competitors or potential competitors to the detriment of competition.

The MCA therefore concludes that cost-orientation for retail prices should be maintained.

Cost Accounting and Accounting Separation

Maltacom, as an undertaking that is subject to retail tariff regulation or other relevant retail control, is obliged under Regulation 37 of the ECNSR to operate and maintain a cost accounting system including related regulatory accounts, that are:

- based on generally accepted accounting practices,
- suitable for ensuring compliance with retail obligations, and
- capable of verification by the MCA

This regulation also allows the MCA to specify the format and accounting methodology to be used by Maltacom.

Furthermore, compliance by Maltacom with the cost accounting system, including related regulatory accounts, referred to above shall be verified by a qualified independent body approved by the MCA. For this purpose, the MCA may carry out an audit itself, or it may require an audit to be carried out by a qualified body, independent of the undertaking concerned. Maltacom is also obliged to publish in its annual accounts a statement concerning compliance by it with a cost accounting system that is in line with the abovementioned requirements.

The MCA deems that accounting separation is also necessary in order for Maltacom to fulfil its obligation of cost accounting and to allow the MCA to monitor the undertaking's actions against market squeeze or other forms of exercise of its market power to influence other markets by, for example, leveraging into related markets. In this light, the MCA considers that the imposition of an obligation of accounting separation upon Maltacom is justifiable, proportionate and based on the nature of the problem identified.

4.4.9 Measures to counter undue preference to specific end-users

Non-discrimination

It is widely recognised that, as a result of their market power, SMP operators may act discriminately with the consequence of causing considerable harm to effective competition in the market. Such discrimination may take various forms, including price offers, information, or conditions of supply.

Under the legal framework currently in force, pending the outcome of the analysis of the markets and the identification of SMP operators, operators in a dominant position are obliged to charge transparent and non-discriminatory tariffs, which shall be appropriately published. Moreover, they are obliged to guarantee equality of treatment except for objectively justifiable restrictions compatible with national or international regulation.

The MCA is of the opinion that the continued imposition of this remedy on Maltacom is necessary given that it is still too early to expect high levels of competition in the retail market and that the measures taken at the wholesale level may not prevent undue discrimination at the retail level.

Transparency

Closely linked with the requirement of non-discrimination is that of transparency. The two remedies may in fact be said to complement each other in ensuring that the SMP operator does not act incoherently when providing a retail service.

Under Regulation 41 of the ECNSR the MCA shall ensure that transparent and up-to-date information on applicable prices and tariffs, and on standard terms and conditions, in respect of access to and use of publicly available telephone services is available to end-users and consumers. Information relating to the identity and contact details of the operator, the description of the service and what is covered by the charge being levied, standard tariffs covering access, all types of usage charges, maintenance, and including details of standard discounts applied and special and targeted tariff schemes, the compensation and, or refund policy, the types of maintenance service offered, standard contract conditions, dispute settlement mechanisms and end user rights as regards universal service ought to be published by the operator.¹⁷

Moreover, the MCA shall encourage the provision of information to enable end-users, as far as appropriate, and consumers to make an independent evaluation of the cost of alternative usage patterns by means of, for instance, interactive guides.¹⁸

In accordance with Regulation 40 of the ECNSR an undertaking providing connection and, or access to the public telephone network is obliged to provide its subscribers with a written contract containing a number of minimum specifications¹⁹. Any proposed changes to the conditions of the contract must be notified to the subscriber not less than thirty days prior to their taking of effect, together with the notification that the said subscriber may withdraw without penalty from such contract.²⁰

The MCA concludes that in view of the principle of transparency, Maltacom should also continue to have the obligation to inform the MCA of any modifications to terms and conditions in particular tariffs, prior to their coming into effect. Such changes shall be subject

¹⁷ Regulation 41(1) and Ninth Schedule of the ECNSR

¹⁸ Regulation 41(2) of the ECNSR.

¹⁹ These relate to the identity and address of the supplier, services provided, the service quality levels offered, as well as the time for the initial connection, the types of maintenance service offered, particulars of prices and tariffs and the means by which up-to-date information on all applicable tariffs and maintenance charges may be obtained, the duration of the contract, the conditions for its renewal and termination of services and of the contract, any compensation and the refund arrangements which apply if contracted service quality levels are not met, and the method of initiating procedures for settlement of disputes.

²⁰ Article 22(4) of the ECRA.

to MCA approval. The *modus operandi* and required time spans between notifications by Maltacom and their approval are to be stipulated following a consultative process.

4.4.10 Measures to counter the unreasonable bundling of services

One of the major concerns of the MCA as guarantor of effective competition in the retail access markets is the ability of Maltacom as an SMP operator to bundle its retail products by leveraging into related markets and distorting pricing. On the other hand, the MCA recognises that such bundling of retail products may lead to economies of scale or scope for the operator and this in turn can lead to savings to the consumer.

In considering the above, the MCA deems that there is a need to counter the risk of anti-competitive behaviour through bundling by means of an obligation to be imposed on Maltacom over and above those mentioned earlier on with respect to transparency. The main aim of such obligation would be that of preventing foreclosure of the retail access markets.

One must note that under the regulatory regime currently in force, and which will remain in force until the finalisation of the market analysis and identification of SMP in the market, operators providing telephony services having a dominant market position are already obliged not to bundle a number of services into a single tariff without also offering each of the constituent services under separate tariffs unless they would have obtained the MCA's prior approval.²¹

In line with this approach, the MCA feels that it will benefit the competitiveness of the retail access markets if this obligation continues to be imposed on Maltacom to the effect that the said operator shall not unreasonably bundle services.

Such remedy would be imposed without prejudice to the rest of the remedies that are to apply across the board irrespective of whether products and services are bundled or otherwise. Moreover, such obligation should apply irrespective of the nature of the services that are being bundled with the services falling within the retail access markets.

04.5 Summary of response to the National Consultation and MCA replies related to the proposed remedies

In its National consultation, the MCA stated that it believed *'it is unlikely that within the period of this review there will be any development of effective competition in the identified markets relating to retail access to the public telephone network at a fixed location'*. One respondent stated that this comment is unrealistic in view of the cable infrastructure and the BWA networks to be deployed soon. According to the respondent this statement does not reflect the existing and near future situation.

The MCA does not agree with the respondent that this statement is incorrect. Throughout the document the MCA is not disputing the fact that there will be other networks in the near future in the market, but given Maltacom's position in the market it is clear that it will continue to have SMP during the timeframe of this review.

One respondent argued that the remedies imposed on the identified ISDN access markets are rather incongruous and their cost will also be disproportionately high compared with any potential benefits that might be experienced, considering the tiny markets involved. The

²¹ Regulation 30(1)(ii) of LN 151 of 2000.

respondent quoted statistics from the consultation document that at the end of 2004, there were just above 300 ISDN PRA exchange lines, around 1,200 business ISDN BRA exchange lines and less than 200 residential ISDN BRA exchange lines. The respondent recommended that the MCA should revisit the scope of regulatory intervention in these identified markets.

The MCA believes that 'small' number of ISDN exchange lines is the result of a small market. Nevertheless, the market trend shows that the total number of ISDN connections is increasing. The MCA is of the opinion that the set of remedies proposed for ISDN markets are necessary in order to protect the customers of these services, given that Maltacom is the only provider of ISDN connections.

Access to wholesale inputs – wholesale line rental

A respondent argued that the fact that a cable operator was opting to enter into the market for the provision of voice services and the consideration that a number of new operators were interested in entering the voice services markets should act as a constraint on the decision to impose a remedy of wholesale line rental. Furthermore, the respondent argued that an international analysis of the implementation of wholesale line rental evidences significant difficulties and significant costs for implementation, especially for small markets such as Malta.

The MCA recognises that there may be complexities and that an operator may incur substantial costs in the practical implementation of a wholesale line rental solution. Set against these complications however are the manifest benefits to the consumer as a result of such a solution particularly of ease of payment, simplicity, and clarity of operation. The experience in other jurisdictions has confirmed that, with regard to carrier pre-selection, the availability or otherwise of a single billing solution could determine which provider an end-user would ultimately select. A single billing solution provided through wholesale line rental would allow for a level playing field for new entrants in that they may offer their customers a single bill for access and calls.

Nonetheless, bearing in mind the potential complexities of implementing a wholesale line rental solution, the MCA is, at this stage, imposing on Maltacom an obligation to provide a solution whereby carrier pre-select operators shall be able to provide a single bill to their customers for access and calls, irrespective of the fact that such access may be provided to the customers by Maltacom. This may take the form of a wholesale line rental solution or any other similar solution. In all cases however, the MCA directs that, at this initial stage, any solution provided should not be at an additional cost to the carrier pre-select operator. Moreover, such a solution should be transparent and offered in a non-discriminatory way.

This notwithstanding, the MCA will monitor developments in the market and keep this decision under review. In circumstances where Maltacom fails to provide an effective single billing solution, the MCA reserves the right to require Maltacom to commence provision of a Wholesale Line Rental solution according to any specifications that may be required. Furthermore, the MCA also reserves the right to intervene as necessary in order as to facilitate the development of any single billing solution in accordance with its powers at law.

Retail remedies

In the national consultative document, the MCA felt that the wholesale remedies imposed on the incumbent, that is Carrier Selection and Pre-selection together with Wholesale Line Rental or single billing solution, are not by themselves enough to bring about the objectives set in Article 4 of the ECRA. As a result, the MCA proposed to impose on Maltacom the following retail remedies:

- price-cap as a measure to counter the charging of excessive pricing,

- cost orientation and cost accounting in order to counteract measures which inhibit market entry or restrict competition,
- non-discrimination and transparency as measures to counter undue preference to specific end-users, and
- measures to counter the unreasonable bundling of services.

One respondent acknowledged that there may be an argument for imposing wholesale remedies which are limited in scope and duration, however it argued that a reasoned opinion to back the imposition of retail remedies is lacking.

The MCA does not agree that this is the case. In the national consultation paper, the MCA explained that effective competition in retail access markets has not developed yet. Till July 2005, Maltacom was the only operator providing fixed access services. Moreover, it is to be noted that although CS and CPS obligations have been an obligation at law since 2002, competition has not yet fostered. The Authority therefore believes that Maltacom will continue to enjoy a strong position and a persistent high market share in the retail markets within the timeframe of this review.

The MCA is of the view that while the imposed wholesale obligations, that is, Carrier Selection and Pre-Selection together with wholesale line rental or a single billing solution are required, these are not sufficient to ensure that Maltacom does not exploit its market position unfairly to the disadvantage of consumers and competition. The lack of competition at a retail level is a sufficient reason to impose the said retail remedies.

With reference to the price cap remedy proposed by the MCA, the same respondent argued that even in a scenario where its retail tariffs are not regulated, Maltacom cannot realistically increase its access prices without effectively losing a large part of its market to competitors. The respondent added that there is no need to require both price cap and cost orientation/cost accounting for retail pricing concurrently stating that the imposition of just one of the remedies is sufficient to address the perceived potential problem. The respondent argued that the reason put forward by the MCA for imposing both price cap and cost orientation obligations on Maltacom is the prevention of excessive prices. It adds that this would mean that there are two separate obligations aimed at safeguarding against the same theoretical type of potential abuse

The MCA disagrees with this comment. In the national consultation document, it is made clear that both remedies serve different purposes. While cost orientation ensures that an operator bases its prices on costs, a price cap mechanism is intended to cap a maximum price and to drive prices down over a period of time

The MCA has noted that, since the publication of the national consultation the fixed access market has developed further with the cable operator seeking interconnection with other public voice telephone service providers and with the grant of three BWA licences.

The MCA is of the opinion that such operators, especially Melita Cable, will exert competitive pressure on Maltacom since consumers would have a feasible alternative to Maltacom's product. Despite the fact that the MCA does not expect that any alternative operator will erode the market power enjoyed by Maltacom, at least within the timeframe of this review, the MCA believes that this pressure will to a limited extent constrain Maltacom from increasing its prices. For this reason, the MCA decides that the imposition of a price cap mechanism on Maltacom is no longer necessary and that an obligation of cost-orientation will be sufficient to ensure that Maltacom's prices are sufficiently geared towards efficient costs. Nevertheless, the MCA reserves the right to review its decision should there be any instances of market failure in this regard.

With regards to imposition of transparency obligation at a retail level one respondent stated that under this proposed remedy, Maltacom would be obliged to seek the MCA's approval for every tariff change it wishes to make. Furthermore, it would have to allow a time span to elapse between the notification of the tariff change and the implementation thereof. This requirement, it adds, is overly cumbersome and inefficient and can lead to delays that prejudice Maltacom's competitive flexibility in the market. In any case the time span required elapsing between the notification of the tariff change and the implementation thereof should be short enough to enable Maltacom to compete effectively.

The MCA agrees that Maltacom would be obliged to seek approval for any changes in the terms and conditions associated with retail fixed access, including retail tariffs. The Authority does not agree that the process needs to be cumbersome and inefficient. To this effect, the MCA has already made it clear that the process is subject to open consultation. The MCA believes that such a consultation would lead to both an efficient result and application of the necessary remedy.

The same respondent argued that in an era where dual, triple and quadruple play are becoming ever-important, the imposition of blanket ex-ante restrictions on bundling risks slowing down the introduction of competitive and innovative service offerings which are beneficial to the customer. It added that Maltacom's advantage in bundling is greatly limited given that existing and upcoming operators will be equally or better positioned to bundle services.

The respondent argued that limitations on bundling are not required since customers have the choice to refuse any conditions imposed by the bundling party simply by taking their custom to other strong full-service network operators present in the market. In this sense, ex-post competition law represents a sufficient safeguard to address competition problems that might arise in this market.

In its national consultation document, the MCA directed Maltacom not to unreasonably bundle its retail fixed access service. More specifically, Maltacom should not bundle a number of services which include fixed access into a single tariff without also offering fixed access under a separate tariff unless granted approval by the MCA. The MCA is of the opinion that this obligation will not in any way restrict or slow down the introduction of any competitive and innovative service offering.

On the other hand, the MCA does not concur with the respondent that Maltese customers have the choice to refuse any conditions imposed by the bundling party simply by taking their custom to other strong full-service network operators on the market. This only occurs in markets which are effectively competitive. In this case the operator which was found to have significant market power can resort to anticompetitive behaviour. The MCA is of the opinion that ex-post competition law is not sufficient to address competition problems that might arise in this market

04.6 Summary of obligations

Given the position of dominance held by Maltacom in the fixed access market, the MCA is to impose on Maltacom the following obligations:

Access to wholesale inputs

1. Imposition of Carrier Selection and Carrier Pre-selection (with associated remedies of non-discrimination, transparency, price and cost accounting, and accounting separation)
2. Imposition of wholesale line rental or single billing solution (with associated remedies of non-discrimination, transparency, price and cost accounting, and accounting separation)

Retail remedies

1. Cost orientation of retail prices
2. Transparency and Non-discrimination;
3. Cost accounting and Accounting Separation;
4. Measures to counter the unreasonable bundling of services

04.7 Monitoring Market Developments

The MCA considers that it would be sensible to keep a reasonably close watch on market developments following this review. This would ensure that the obligations on the SMP operator would be justified throughout the duration of this market review. If the MCA deems necessary or appropriate a new market review would be undertaken at any time in response to changing market conditions.

Appendix A

The table below illustrates the current monthly access charge and the cost of calls for different time bands for residential and business customers charged by the fixed incumbent.

Fixed Access Charges *		
	Residential Rates	Business Rates
Connection Charge	Lm23.60	Lm47.20
Monthly Rental Charge	Lm2.57	Lm6.69
Free Pulses ¹	20 monthly <i>Free pulses can be consumed only by local calls terminated on fixed lines made during the Night band (6.00pm-6.00am) and not for Internet/VoIP access.</i>	None

Fixed Call Charges *		
Monday to Friday (including Public Holidays)		
OFF PEAK (6.00am -8.00am)	5.39 cents every 10 minutes or part thereof	5.90 cents every 10 minutes or part thereof
PEAK (8.00am - 6.00pm)	5.39 cents every 5 minutes or part thereof	5.90 cents every 5 minutes or part thereof
NIGHT (6.00pm - 6.00am)	5.39 cents every 30 minutes or part thereof	5.90 cents every 30 minutes or part thereof
Saturday and Sunday		
OFF PEAK (6.00am -6.00pm)	5.39 cents every 10 minutes or part thereof	5.90 cents every 10 minutes or part thereof
NIGHT (6.00pm - 6.00am)	5.39 cents every 30 minutes or part thereof	5.90 cents every 30 minutes or part thereof

Source: Maltacom plc website

* All charges are in Maltese currency²² and inclusive of VAT

1. A pulse is equivalent to 5 minutes.

²² Exchange Rate 1€ = Lm0.43

The following table compares the charges in Maltese lira of making a fixed or mobile call for residential and non-residential customers.

	1 min peak ¹ call (weekdays)		3 min peak call (weekdays)	
	Fixed - Fixed	Fixed - Mobile	Fixed - Fixed	Fixed - Mobile
Maltacom				
Residential	5c39	12c5	5c39	37c5
Non-residential ²	5c90	12c5	5c90	37c5
	Mobile - Fixed	Mobile- Mobile	Mobile - Fixed	Mobile- Mobile
Vodafone				
Pre-paid Scheme				
eone	30c	20c	90c	60c
etwo	22c	22c	66c	66c
ethree	18c	18c	54c	54c
Family & Friends ³	12c	12c	36c	36c
Post-paid Scheme				
Lite (calls in bundle)	22c85	22c85	68c55	68c55
Lite (outside bundle)	14c	14c	42c	42c
active (calls in bundle)	12c14	12c14	36c42	36c42
active(outside bundle)	12c	12c	36c	36c
extra (calls in bundle)	10c54	10c54	31c62	31c62
extra (outside bundle)	10c	10c	30c	30c
Go Mobile				
Pre-paid Scheme				
Ready to go	20c	20c	44c	44c
Ready to go Club ⁴	12c	12c	36c	36c
Post-paid Scheme				
On the go (calls in bundle)	26c67	26c67	80c01	80c01
On the go (outside bundle)	11c5	11c5	34c5	34c5
Go together (calls in bundle)	20c	20c	60c	60c
Go together (outside bundle)	10c	10c	30c	30c
Business go (calls in bundle)	12c14	12c14	36c42	36c42
Business go (outside bundle)	10c	10c	30c	30c

Sources: Maltacom, Go Mobile, Vodafone websites

All charges are inclusive of the applicable VAT rates.

'Calls in bundle' for post-paid schemes has been estimated as the monthly rate divided by the free minutes in bundle.

1. Peak hours for mobile operators are from 8.00am – 8.00pm whilst for fixed operator are from 8.00am – 6.00pm.
2. Non-residential customers can claim back the 18% VAT from government.
3. Family & Friends scheme includes only 3 numbers (fixed and/or mobile), which the customer can choose to call at reduced
4. Ready to go scheme includes only 3 numbers (fixed and/or mobile), which the customer can choose to call at reduced.

Appendix B

4 November 2005

Chairman
Malta Communications Authority (MCA)

Attn Mr Victor Zammit

Dear Mr Zammit

The Office for Fair Competition (OFC) have been asked below to provide its opinion with respect to the outcome of the MCA's review and market analysis of the following retail and wholesale markets:

1 Retail markets

Market 1 - Access to the public telephone network at a fixed location for residential customers

Market 2 - Access to the public telephone network at a fixed location for non-residential customers

Market 3 - Publicly available local and/or national telephone services provided at a fixed location for residential customers

Market 5 - Publicly available local and/or national telephone services provided at a fixed location for non-residential customers

2 Wholesale markets

Market 8 - Call origination on the public telephone network provided at a fixed location

Market 9 - Call termination on individual public telephone networks provided at a fixed location

Market 10 - Transit services in the fixed public telephone network.

The Office takes the view that the exercise undertaken by MCA to define the above proposed markets applied principles based on best practice for defining relevant markets in competition analysis. The Office believes it is reasonable to accept MCA's findings that the proposed retail and wholesale markets exist in Malta, at least for the period under review. Nonetheless, MCA should monitor market developments in this regard.

We would note that these OFC views and opinion have been made in the context of the specific provisions of the SMP guidelines relating to the relationship between markets defined for the purposes of ex-ante regulation vis-à-vis competition law enforcement. The OFC reserves the right to re-examine any or all of the issues underlying these MCA recommendations in the light of facts and evidence that may arise in specific future cases before it.

Yours sincerely

Martin Spiteri
f/Director General
Consumer and Competition Division