Malta Communications Authority

National telephone services provided at a fixed location

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

Consultation Document

Date 14th October 2005

Malta Communications Authority
Il-Piazzetta, Suite 43/44,Tower Road, Sliema SLM 16,
Tel: (+356) 21336 840
Fax: (+356) 21336 846

Contents

Page

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 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 review sets out the Malta Communications Authority's (MCA) proposal for identifying relevant markets and making market power determinations. Those likely to be effected may forward their comments within the period ending on Friday 25th November 2005. Arrangements for submitting comments are explained in **Chapter 05**.

As required by Article 7 of the Framework Directive (as implemented by Article 4 of the Electronic Communications (Regulation) Act), the MCA's proposals will be notified to the European Commission.

Summary of Proposals

Identification of Markets

The group of products and services under consideration in this document consists of national telephony services provided at a fixed location. In Malta, these services are predominantly being provided by the incumbent fixed telephony operator.

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

1. Residential national telephone services provided at a fixed location.

2. Non-residential national telephone services provided at a fixed location.

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 proposes that Maltacom plc. should be designated as having significant market power in the above mentioned markets. The main reasons justifying the proposed designation are:

- a 99 per cent market share;
- vertically integrated provider;

- high economies of scale and scope;
- lack of countervailing buyer power; and
- potential competition.

Full details of the MCA's draft 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 national telephone services provided at a fixed location – i.e. their ability to behave to an appreciable extent independently of competitors, customers and ultimately consumers – the MCA proposes to impose the following conditions:

Wholesale Obligations:

– Carrier Selection and Carrier Pre-selection

– Access to/and use of specific network facilities

– Non- discrimination

– Transparency

– Price control & cost accounting

– Accounting Separation

Retail Obligations:

– Price Cap

– Cost Orientation for retail prices

– Cost accounting

– Transparency and non-discrimination

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 are 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 regulatory regime and sets out fundamental rules and objectives across all the 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 fifth Directive on Privacy establishes users' rights with regard to the privacy of their communications, 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 sector[1]. The MCA is required to take these guidelines into utmost account when analysing a product or service market in order to access 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 measured 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 is to publish the results of the market reviews and to provide 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.

In line with our national consultation process, the consultation period will run from Friday 14th October to Friday 25th November 2005 during which the MCA welcomes written comments on any of the issues raised in this paper. Further details on the public consultation are provided in **Chapter 05**.

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 (NCAs).

In line with the co-operation agreement signed on the 20th May 2005 between the MCA and the Office of Fair Competition (OFC)[2], the MCA has initiated a two week consultation process with the OFC. The MCA has forwarded and presented the results of this review to the OFC. The OFC is in the process of forwarding its comments to the MCA in writing in the coming days. Upon receipt of this letter the MCA will make it available to the general public.

01.4 Scope of this Review and the Extent of Existing Regulation

This review considers the markets for national telephone services provide at a fixed location in Malta (hereafter referred to as the 'national calls markets'), which includes all products and services which allow end-users to make national calls over the public telephony network.

Q1. Do you agree with the scope of the MCA's review for national telephone services provided at a fixed location?

[2] 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 MCA's preliminary conclusions on the definition of the markets for national call 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 MCA's market analysis for the national calls markets and outlines a preliminary view on whether this market is effectively competitive or those undertakings with significant market power.

Chapter 04 provides a discussion of the general principles associated with remedies and outlines the proposed remedies on SMP operators, under the new regulatory framework; and

Chapter 05 provides details with regard to the submission of comments on this consultation document.

Chapter 02 - Market Definition

Regulation 10 of the ECNSR provides that before a market power determination may be considered, the MCA must identify the markets which are, in its opinion, the ones which, in the circumstances of Malta are the markets in relation to which it is appropriate to consider such a determination and to analyse that market. In identifying the relevant markets, the MCA is required to take utmost account of all applicable guidelines and recommendations issued by the European Commission.

In formulating the MCA approach to market definition, the MCA has paid the utmost regard to the Commission's Recommendation.

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.

Paragraph 3.1 of the Commission's Recommendation 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 analysis 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.

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

02.1 Background to the electronic communications sector in Malta

As at December 2004 the total population of Malta stood at approximately 395,000. 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 the first nine months of 2004 the contribution of the electronic communications sector towards the Gross Domestic Product was just over 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 MCA[3].

In Malta, the incumbent fixed telephony services operator - Maltacom plc[4] - is the only undertaking that provides fixed access and calls over the 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 plc[5]. This is a typical hybrid fibre coaxial (HFC) cable network, the primary use of which is the delivery and provision of cable TV. Melita Cable undertook a network upgrade in the late 1990s in order to render their 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 HFC network via cable modem. Furthermore, as from last July the cable operator started to offer a VoBB product. This product enables cable subscribers to make on-net and international calls only for the time being. To date the cable operator has not concluded any interconnection agreements with other operators and therefore subscribers cannot make off-net local calls.

02.2 Delineation of the national calls 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 call products and services in Malta, taking also a forward looking approach with respect to possible developments in the market under review.

2.2.1 Residential and non-residential national calls

Demand substitutability

In the market review of the fixed access markets[6] the MCA has defined separate markets for residential and non-residential access markets. The distinction was justified since both the PSTN incumbent and the cable operator, which currently provide access services, are able to distinguish between the two types of customers based on a number of requirements when applying for the services. Both operators are therefore able to adopt different pricing strategies for the two types of customers. Moreover, certain terms and conditions for the provision of access services, such as billing arrangements, differ for residential and non-residential customers.

At present non-residential customers cannot switch to residential status following a hypothetical increase in the price of national fixed calls because undertakings are able to distinguish between customers and identify the use of each line i.e. whether it will be used as a residential or business line. Therefore as similarly explained in the market review for access markets customers cannot choose which connection they want but are obliged to

[3] Link to document on the MCA website: http://www.mca.org.mt/library/show.asp?id=543&lc=1

[4] Hereinafter referred to as Maltacom

[5] Hereinafter referred to as Melita Cable

[6] Link to report www.mca.org.mt

take the residential connection if it is to be used for residential purposes and the non-residential connection if it is for business use.

Supply substitutability

The PSTN incumbent and the cable operator are already providing access and calls to both residential and non-residential customers. There are no existing operators providing call services to one type of customer only and which could start supplying calls to the other type if a hypothetical monopolist increases the price of national fixed calls.

In a hypothetical scenario where new operators enter the calls market during the timeframe of this review, the MCA does not have any information on whether these alternative operators would be differentiating between residential and non-residential customers. However, from past experience and also based on current pricing strategies applied for other electronic communications services, operators tend to differentiate between residential and non-residential customers. This would indicate that even in the hypothetical scenario where new entrants start providing call services, the distinction between residential and non-residential customers would still apply.

Preliminary Conclusion

The MCA considers that residential local calls and non-residential local calls are in a separate relevant market.

2.2.2 National calls to fixed and mobile numbers

Demand substitution

At first glance, the most likely demand-side substitute for a call from a fixed line to another fixed line is a call from a fixed line to a mobile number. From a demand-side analysis, whilst there may be some circumstances where a call from a fixed line to another fixed line can be substituted by a call to a mobile number, the MCA believes that the two are not complete substitutes. There are circumstances were the calling party is aware that the called party is not reachable via a fixed-to-fixed call. In such cases, the caller will have no choice but to make a mobile call if immediate contact is required. On the other hand, if the called party is known to be reachable on a fixed line the caller may well call the fixed line given the significant price differential between the two types of calls. Appendix A compares the tariffs that the customer incurs when making a fixed call to another fixed line and to a mobile number.

Based on this price schedule it is clear that the cost of making a fixed-to-mobile call is significantly more expensive than making a fixed-to-fixed call. This implies that from a demand side substitution level there is little possibility that consumers would opt to substitute fixed-to-fixed calls for fixed to mobile calls unless required to do so for immediate communication.

Notwithstanding the above, the MCA notes that service providers offering voice calls tend to offer users an entire range of call types, including calls to fixed and calls to mobile, as a cluster of services. When purchasing calls, consumers do not purchase calls to fixed and calls to mobile separately. These are purchased as a single cluster of call services. In this sense, calls to fixed and calls to mobile fall within the same relevant market.

Supply-side substitution

In assessing supply side substitutability between a fixed-to-fixed and a fixed-to-mobile call the MCA considered whether a hypothetical monopolist providing fixed voice calls would be able to profitably increase prices above competitive levels without providers of calls to mobile being able to enter the market and undermine the price increase.

As argued above, service providers currently offering fixed voice call services tend to offer an entire cluster of call types in that when consumers acquire calls, they do not purchase calls to fixed and calls to mobile separately but as a cluster of call services.

The introduction of CS and CPS services makes it easier for potential new entrants to start providing fixed calls. If a hypothetical CS or CPS operator starts providing fixed-to-mobile calls, then it would be relatively easy for that operator to start providing fixed-to-fixed calls in response to a small but significant non-transitory price increase in the fixed-to-fixed calls by a hypothetical monopolist. The infrastructure used by a CS or CPS operator to provide fixed-to-mobile calls is essentially the same for providing fixed-to-fixed calls. Consequently, the CPS operator would be well placed to enter the market for fixed-to-fixed calls in a relatively short period of time following a hypothetical price increase. This reasoning also holds true for undertakings which have their own access network infrastructure in place.

Consequently, the MCA considers that there exists sufficient supply-side substitution between fixed calls to mobile numbers and fixed-to-fixed calls, and hence they are in the same relevant market.

Preliminary conclusions

The MCA considers that fixed-to-fixed national calls and fixed-to-mobile national calls are in the same relevant market.

2.2.3 National calls from fixed locations and mobile calls

A user wanting to make calls from home has the option of either using his fixed line connection or his mobile phone. The analysis of the extent to which a user would choose to make mobile calls rather than fixed calls has to take into consideration two scenarios. First, when the user is willing to substitute calls from a fixed line with calls from a mobile phone on a call-by-call basis, and a second scenario where the user decides to switch all calls-from-fixed to calls-from-mobile.

Demand-side substitutability

Functional substitutability

As described in detail in the market review for fixed access services, there are several factors, which in the opinion of the MCA makes a call originating from a mobile phone functionally different from a call originated from a fixed line. 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 calls in one direction only, that is, by replacing calls from a fixed line with a call from a mobile phone but not vice versa.

It is therefore appropriate to consider a call from a mobile phone to be functionally different from a call from a fixed line and users would not likely to substitute all their calls from a fixed line to mobile originating calls.

Prices

As explained in the market review for fixed access services, due to the pricing structures of mobile tariff plans it is very difficult to compare the cost of mobile usage with the more straightforward fixed line tariffs. While access and calls are bundled together in the case of pre-paid mobile tariff plans, mobile post-paid charges include a bundle of minutes. Notwithstanding, the customer will normally consider the actual cost that the call is going to cost them, and therefore one can compare the actual incurred cost of making a call from a fixed line and a call from a mobile phone.

The price schedule in Appendix A shows that a one-minute call from a fixed line to another costs 5c39 for residential and 5c90 for a non-residential customer. If the user decides to make the same call from a mobile phone the cost for a pre-paid user would range from 12c up to 30c per minute, and that for a post-paid user would range from 10c up to 26c67 depending on the scheme the user is using. This implies that making a call to a fixed line from a mobile phone would on a best deal basis cost twice as much as a fixed call. When one considers the same call but with a duration of three minutes, the costs of a fixed to fixed call would remain the same, whilst the cost of the call from a mobile would be three times as much, since mobile calls are charged on a per second basis and fixed calls charged in steps of 5 minute pulses. It is therefore unlikely that a customer would substitute a fixed-to-fixed call with a mobile-to-fixed call unless strictly required to for immediate communication.

When one considers the cost of making a call to mobile, the price differential between making the call from a fixed line or from a mobile phone is somewhat less pronounced. The cost of making a fixed-to-mobile call is 12c5 per minute for residential and non-residential customers. The cost of a mobile-to-mobile call ranges from 12c up to 22c per minute for pre-paid users, and from 10c up to 26c67 per minute for post-paid customers. This implies that on a best deal basis a user making a call to a mobile number would sustain the same cost per minute whether he/she originates the call from a fixed or mobile phone. However, the lower range of mobile prices is only associated with either a maximum of three numbers for pre-paid users[7], or with heavy users for post-paid customers (i.e. minutes outside the bundle of free minutes).

The MCA is of the opinion that the price comparisons are such that even following a 5 to 10 per cent hypothetical increase in the price of national fixed calls, the fixed rates will remain at levels well below those of mobile call charges. As explained in market review for access markets the MCA considers that users will not substitute all their fixed calls with mobile originating calls within the timeframe of this review. The significant price premium that mobile calls carry is an indicator that calls from fixed line and calls from mobile phones are not subject to the same pricing constraint.

The price differentials presented here are also reflected in consumers' perceptions and usage habits. In a survey carried out on behalf of the MCA, 60.3 per cent of respondents replied that they would make less calls if the price of fixed local calls had to increase by a 5 to 10 per cent in price. Only 34 per cent said they would make the same amount of calls. In another question respondents were asked whether they would start calling more from their mobile phone if the price of fixed line calls increases. Of all the respondents that owned a mobile phone 38 per cent said they would make the same use of their mobile phone and 30 per cent even said they would use it less. One reason for this could be that users who are

[7] Low call charges for pre-paid users are associated with the 'Family & friends' or 'Ready to go club' schemes only. These schemes allow pre-paid customers to choose any three mobile or fixed numbers to which they can call at any time of the day at a flat rate of 12c per minute. Pre-paid users constitute 92 per cent of all mobile subscribers in Malta.

very price conscious would reduce their mobile consumption in order to compensate for the increase in the cost of fixed calls. Only 25 per cent said that they would call more from the mobile phone. This evidence suggests that following a price increase in national fixed calls users are likely to call less and not substitute their fixed calls to calls from mobile.

The MCA is therefore of the opinion that given the different functionality and the significant price premiums of mobile calls, it is very unlikely that during the timeframe of this review customers would switch from making fixed originating calls to mobile originating calls unless required to for immediate contact.

Supply substitutability

When assessing supply substitutability between calls from fixed and calls from mobile one has to consider whether an existing supplier of mobile calls would enter the market of fixed calls in response to a 5 to 10 per cent increase by a hypothetical monopolist of fixed call services.

Supply-side substitution would involve a mobile operator responding to a price increase in fixed line originated calls by switching production and offering fixed services. 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. Such entry would require either the construction of an access network; the development of a wireless product that more closely resembled the fixed access product, or alternatively by investing in CPS. While the high costs involved in developing nationwide infrastructure render supply-side substitution unlikely during the timeframe of this review, entering the market by providing CPS poses no advantage over other potential new entrants. Therefore the MCA considers that there is no real possibility for supply-side substitutability.

Preliminary conclusion

The MCA considers that calls from mobile phones and calls from a fixed line do not fall within the same relevant market.

2.2.4 National calls and Internet calls

Demand substitutability

Internet calls are calls made by customers who need to access the Internet using a dial-up Internet connection. Dial-up Internet access is achieved with the user dialling a number allocated to the chosen Internet Service Provider (ISP). From a functional point of view, voice calls and dial-up Internet calls serve for different purposes in that a voice call cannot be substituted by a call meant to gain access to the Internet.

The MCA notes that operators offering voice calls over a fixed line tend to offer users an entire range of call types, including calls to Internet, as a cluster of services. When purchasing calls, consumers do not purchase calls to fixed and calls to Internet separately. Pricing, terms and conditions of supply and payment terms for calls to Internet do not vary from fixed voice calls, and indeed as mentioned previously are generally supplied as part of a cluster of call types. In this sense, calls to a fixed line and calls to Internet fall within the same relevant market.

Supply substitutability

In assessing supply side substitutability between national calls to a fixed line and an Internet calls the MCA will consider whether a hypothetical monopolist providing fixed voice calls would be able to profitably increase prices above competitive levels without providers of Internet calls being able to enter the market and undermine the price increase.

The introduction of CS and CPS services makes it easier for potential new entrants to start providing call services. If a hypothetical CS or CPS operator starts providing Internet calls, then it would be relatively easy for that operator to start providing fixed to fixed calls in response to a small but significant non-transitory price increase in the fixed to fixed calls by a hypothetical monopolist. The infrastructure used by a CS or CPS operator to provide fixed-to-Internet calls is essentially the same for providing other types of calls. Consequently, the CPS operator would be well placed to enter the market for fixed-to-fixed calls in a relatively short period of time following a hypothetical price increase. This reasoning also holds true for undertakings which have their own access network infrastructure in place.

Consequently, the MCA considers that there exists sufficient supply-side substitution between Internet calls and national fixed calls, and hence they are in the same relevant market.

Preliminary conclusions

The MCA considers that internet calls are in the same relevant market as national fixed calls.

2.2.5 National calls to geographic and non-geographic numbers

Demand substitutability

The MCA considers that from a technical point of view, both geographic calls and calls to non-geographic numbers are originated in similar ways, and are switched services carried in exactly the same way over the network.

A user wishing to call a fixed geographic number would normally not consider a call to a non-geographic service (predominantly premium rate services and freephone services) as a feasible substitute.

The MCA notes that service providers offering national fixed calls tend to offer users an entire range of call types, including calls to non-geographic numbers, as a cluster of services. When purchasing calls, consumers do not purchase calls to geographic and non-geographic numbers separately. In this sense, calls to a fixed geographic numbers and non-geographic numbers fall within the same relevant market.

Supply substitutability

Supply substitutability in the provision of national fixed geographic and non-geographic calls would exist if a hypothetical price increase in national fixed geographic calls would attract existing suppliers of non-geographic calls in the market.

If a provider of calls to non-geographic numbers is already using CPS to provide these calls, then it will have already invested in the infrastructure required to provide all calls through CPS, and so would be well placed to enter the market for voice calls. This reasoning also holds true for undertakings that have their own access network infrastructure in place.

Consequently, the MCA considers that there exists sufficient supply-side substitution between national geographic fixed calls and national non-geographic fixed calls, and hence they are in the same relevant market.

Preliminary conclusions

The MCA considers that calls to geographic and non-geographic numbers are in the same relevant market.

02.3 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 takes the view that the relevant geographic market for the markets considered in this review are the Maltese Islands.

02.4 Preliminary markets

Following the analysis presented here the MCA found the following relevant retail national fixed calls markets in Malta:

1. Residential national telephone services provided at a fixed location.
2. Non-residential national telephone services provided at a fixed location.

Q2. Do you agree with the above preliminary conclusions regarding the market definition exercise?

Chapter 03 - Market Analysis

Having identified the relevant market as discussed in **Chapter 02** the MCA is required to analyse the market in order to assess whether any person or persons have 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 new EU 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 important ones are

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

- ✓ Sunk cost
- ✓ Vertical integration

- o Potential competition
- o 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 40 per cent would raise the necessity of designation 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."

As at June 2005 the incumbent, Maltacom, was the only fixed line operator in Malta offering fixed national calls to residential and non-residential customers. At that time there were no alternative network operators and/or Carrier Select (CS), Carrier Pre-select (CPS) service providers in Malta. The market structure therefore implied that Maltacom had a 100 per cent market share in both the residential and non-residential national fixed calls markets. Moreover, Maltacom had an implicit 100 per cent market share when calculating the revenues associated with the fixed local call services for both residential and business customers.

During July 2005, Melita Cable which operates a nation-wide cable network, launched a VoBB telephony service which, up to the date of publication of this review, allows its customers to make on-net calls and international calls only. To date, Melita Cable does not have any interconnection agreements with other local operators and therefore customers cannot make off-net calls. Given this limitation, this service is currently not fully substitutable with the traditional fixed telephone services provided by Maltacom.

Given the very early stage of development of this service, the MCA has very little information on the penetration and volumes of this cable VoBB service. However the MCA is aware that as at September 2005 the number of subscribers of this cable VoBB service is approximately 2,000. This figure is insignificant in contrast to the 202,714 subscribers connected to Maltacom's PSTN network as at June 2005. Given that the cable VoBB service has only been offered for the past three months, it is very difficult to estimate the volumes of traffic passed over the network. Nevertheless, the MCA considers that the small number of subscribers currently using the cable VoBB services, and the short period of time since the service is being offered, is reflected in limited volumes of traffic. The MCA considers that until a significant number of customers are making use of the cable VoBB service, it is unlikely that Maltacom's presumed dominance in providing fixed national calls to residential and non-residential customers would be significantly impacted.

The MCA is of the opinion that in the absence of regulation Maltacom would be able to exert market power in the fixed calls markets for both residential and non-residential customers.

The 99 per cent market share of Maltacom suggest that it has significant market power in the fixed national call 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 to continue enjoying significant market power during the timeframe of this review. Nonetheless, the MCA will monitor closely any developments in these markets and will revise its analysis accordingly if the structure of the markets changes significantly.

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 the provision of fixed call services. Given that this undertaking is currently providing the majority of national fixed calls in the market, the cost of providing an end-to-end call is likely to be much lower than those of a new entrant. A new entrant would need to take a large share of the calls 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 national fixed calls below the incumbent's prices, which would make it very difficult for this operator to cover its start-up costs.

Moreover, the prices that Maltacom charges for fixed national calls are currently regulated by the MCA. This makes it very difficult for any other operator to price calls below the price charged by the incumbent fixed telephone operator, unless it is more efficient in its operations or uses a more cost-effective technology. Nonetheless, in the absence of regulation Maltacom would still be able to meet low national call prices from potential competitors given that it has a very large market share.

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 markets it can share common costs over a greater range of services.

Maltacom is the fixed incumbent and is therefore present in a large number of electronic communications markets providing a large number of services over its ubiquitous network. The ability to benefit from economies of scope may act as a barrier to entry for new competitors.

The ability of Maltacom to benefit from such economies of scope suggests that this undertaking is likely to enjoy SMP in the national fixed call 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.

In order to supply fixed calls an operator would need to develop an access network that requires a large upfront investment resulting in significant sunk costs. This is a major barrier to entry for alternative operators in the fixed calls market. In May 2004 the MCA directed Maltacom to provide the necessary access services to any operators wishing to provide CS and CPS services.[8] This means that alternative operators can now make use of the incumbent's network and would not need to deploy their own network. This measure reduces significantly the entry costs for alternative operators in the fixed calls markets. However, to date there are no CS and/or CPS service providers providing national fixed calls.

Vertical Integration

Vertical integration involves an undertaking operating in a given market, which is also 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 hypothetically 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 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, therefore constraining incumbent firms. The threat of potential entry may prevent firms from raising prices above competitive levels, leading thereby to situation in which no market power can be profitably exercised.

The potential entry of a CS or CPS service provider would enhance competition in the national fixed calls market in Malta. However, the MCA is of the opinion that within the timeframe of this review the entry of a CS or CPS operator in national fixed calls market will not be sufficient to pose a sufficient threat on the market power enjoyed by the fixed incumbent.

A much more realistic potential competitive constraint can come from the recent entry of the cable operator in the market for national fixed calls. As stated earlier in July 2005 the cable operator launched a cable VoBB service which enables its customers to make on-net calls and international calls. The MCA is of the opinion that when the cable operator starts to interconnect with other local operators, its VoBB service will compete with the traditional fixed telephone services offered by Maltacom. However until the cable operator interconnects with other local operators, customers using the cable VoBB service would not

[8] http://www.mca.org.mt/library/show.asp?id=434&lc=1

be in apposition to have only one telephone line connection (i.e. cable or PSTN) since customers wanting to call a PSTN number would still need access to the Maltacom PSTN network and its fixed telephony services. The MCA is therefore of the opinion that until the cable operator interconnects with other local operators the cable VoBB services would not be in a position to compete at par with the incumbent's fixed call services 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 of fixed telephony services for the time being.

Another potential development in the market will be the introduction of voice call 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 VoBB services and offering wholesale call origination services over their network. 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 of VoBB telephone services is likely to increase the level of competition in the fixed calls market in the future. However, the MCA considers that this type of service is still emerging in Malta and it will not erode the significant market power held by Maltacom within the timeframe of this review. Nonetheless, the MCA is going to monitor closely the development of competition in the fixed calls markets and will consider revising its conclusions if the market structure changes considerably

3.2.3 Countervailing buyer power

The existence of customers with a strong negotiating position, which can 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. As stated before Maltacom is currently the only provider of a ubiquitous fixed telephone service in Malta..

Small businesses, which account for a very large portion of total businesses in Malta[9,] 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 Maltacom, can exert to a limited extent some countervailing buyer power. Notwithstanding, the MCA is of the opinion that in absence of alternative providers that offer a ubiquitous fixed telephone service 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 the price of national fixed calls in absence of regulation.

03.3 Preliminary conclusions and SMP designations

The evidence presented above suggests that Maltacom, enjoys significant market power in the provision of national calls in the residential and non-residential markets.

---

[9] 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.

This preliminary conclusion is supported by a number of factors including:

- its 99 per cent market share in the provision of national fixed calls;
- the fact that it is a vertically integrated provider supplying a full range of electronic communications services both at wholesale and retail level;
- the economies of scale and scope it enjoys in these markets; and
- the lack of countervailing buyer power.

Consequently, the MCA concludes that Maltacom should be designated as having significant market power in the following retail markets:

1. Residential national fixed telephone services
2. Non-residential national fixed telephone services

Q3. Do you agree with the above preliminary conclusions regarding market analysis? Please provide a reasoned response.

Chapter 04 – Regulatory Implications

As evidenced above, this market review has defined two relevant markets in Malta with respect to national telephone services provided 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.

Moreover, in accordance with Article 17 of the Universal Service Directive, Regulation 37 of the ECNSR requires the MCA, after having designated an operator as having significant market power on a relevant retail market, to impose on such operator such obligations as it considers appropriate to achieve those objectives set out in Article 4 of the Electronic Communications Regulation Act, where the MCA determines, as a result of a market analysis carried out in accordance with regulation 10 of the said regulations, that the given retail market, as identified in accordance with regulation 9 of the same regulations, is not effectively competitive and concludes that obligations imposed under Part III or regulation 39 of the said regulations would not result in the achievement of the objectives set out in Article 4 of the Electronic Communications Regulation Act.

This section thus aims at discussing the actual and potential competition problems that exist in the defined markets, and proposing adequate remedies 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 that denies 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.

The MCA believes that non-price leveraging strategies may have also contributed to the lack of competition in the market. Discriminatory use or withholding of information, delaying tactics, quality discrimination and the imposition of undue requirements on and with respect to potential alternative downstream undertakings may have contributed to the lack of competition that currently exists on the markets concerned.

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 call minutes. Because this bundle cannot generally be replicated by most alternative operators, competitive concerns arise.[10]

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 national telephone services markets is in excess of 95 per cent. Given the ubiquity and the high density of its network, Maltacom enjoys economies of scale in the provision of fixed telephone services. Because Maltacom currently provides all local fixed calls in the market, the cost of providing an end-to-end call 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 curtain as much as possible these competition problems. At present Maltacom's retail domestic calls prices 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 significant market power. 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.

---

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

- 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.

In view of the identified actual and potential competition problems arising from SMP in the market relating to retail national telephone services provided 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 national telephone services provided at a fixed location. Accordingly, the MCA proposes to impose 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 identified markets under review.

In selecting the remedies to impose on designated SMP operator, the MCA has considered the nature of the problem identified and, in accordance with the principle of proportionality, where possible, 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 proposed below should be seen as a complementary suite which support and reinforce each other.

04.4 Proposed Remedies

The MCA is of the opinion that the obligations it is proposing to impose are based on the nature of the competition problems it has identified in the relevant markets it is proposing to define, 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 the proposed 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.

Access to Wholesale Inputs

The main impediment to competition retail market is that it is particularly difficult to replicate the access network required to provide telephony services due to the large sunk costs associated with deploying such a network. According to the Commission Recommendation on relevant markets, such structural barriers '*exist when the state of the technology, and its associated cost structure, as well as the level of the demand, are such that they create asymmetric conditions between incumbents and new entrants impeding or preventing market entry of the latter*'. In such cases effective competition is unlikely to emerge without regulatory intervention

Such structural barriers to entry have been analysed in the previous sections with the conclusion that the replication of the access network owned by Maltacom and Melita Cable is difficult 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.

4.4.1 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.

This obligation was already previously imposed through the Telecommunications Services (General) Regulations, 2000, and continues to apply to Maltacom by virtue of Article 40 of the Electronic Communications (Regulation) Act. However, the MCA notes that it was not until December 2004, following the intervention of the Authority, that Maltacom published cost-oriented call origination prices in its Reference Interconnection Offer.

As mentioned above, Regulation 39(3) imposes the requirement that pricing for access and interconnection related to the provision of these facilities should be cost-oriented. The MCA believes that failure to impose the obligations set in this provision on Maltacom would not result in competition in the retail calls market.

The MCA moreover recognises that further intervention is required to continue to develop the Carrier Selection and Pre-Selection products. It is the view of the MCA that in order to have workable competitive Carrier Selection and Pre-Selection products the Authority's intervention in accordance to Regulation 21, is essential. The MCA believes that this will not be the case if it is left to commercial negotiations alone.

Further to the above set of obligations, which are either automatically mandated or which can be imposed by virtue of Regulation 39 on undertakings found to have SMP on the provision of connection to and use of the public telephone network at a fixed location, additional obligations may be imposed to address competition problems including transparency, non-discrimination, accounting separation, and price control and cost accounting.

Given the problems mentioned above concerning the implementation of Carrier Selection and Pre-Selection, the MCA believes that it would be justified to impose the obligations relating to transparency (Regulation 18) and non-discrimination (Regulation 19) on Maltacom as well. These are discussed further below.

4.4.2 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 competing providers more for wholesale services than the amount charged to their own retail activities thereby increasing the costs of 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.

The MCA believes that an obligation of non-discrimination, as a remedy under Regulation 19, provides the same ability to alternative operators (including providers of VoIP services, and providers of services which are not publicly available telephone services) to obtain call origination at the same price, quality, and terms and conditions, which would apply to Maltacom's own retail arm, subsidiaries or partners. Moreover, the information and services related to the CS and CPS services should be provided in a similar fashion as 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.

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

4.4.3 Transparency

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 authorised 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 call origination pricing in relation to Carrier Selection and Pre-Selection. Under the obligation of transparency that the MCA is proposing, Maltacom will be obliged continue publishing reference offers related to Carrier Selection and Carrier Pre-Selection. Such offers are 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 through consultative process. The implementation of this obligation may also require the publication of other information from time to time.

The MCA expects that any new offerings developed pursuant to Regulations 19, 21 and 39 should also be detailed in a reference offer.

4.4.4 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

As a result of the high structural barriers to entry, 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 found Maltacom to hold significant market power and thus proposed that Maltacom should be directed to provide Carrier Selection and Carrier Pre-Selection. With regards to the pricing for access and interconnection related to these facilities, Regulation 39(3) states clearly that these should be cost-oriented. Therefore the present cost obligation on Maltacom is to be maintained.

Cost accounting systems

As stated above, the pricing for access and interconnection related to Carrier Selection and Pre-Selection is regulated by Regulation 39(3) which states that such prices should be cost-oriented. The Authority believes that a cost accounting system will be necessary to support such an obligation and is therefore proposing to impose 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 company is already under the obligation to support such a system by virtue of a previous MCA decision[11] and that this has already been in place for some time.

The MCA therefore proposes the maintenance of the existing level of cost accounting system obligation on Maltacom until such time that any further consultation on the issue are deemed necessary.

4.4.5 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 possible market failures and provide evidence in relevant markets of the presence or absence of discrimination and margin squeeze. Such obligations support the imposition of transparency as it makes visible the wholesale prices and internal transfer prices of an operators 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 proposes that the existing level of accounting separation on Maltacom as identified under its decision on Accounting Separation[12] is to be maintained until such time as any further consultation is needed.

The MCA believes that if it were withdraw this obligation, it would not have any means of monitoring non-discrimination 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;
- not to bundle services into a single tariff without also offering each of the constituent services under separate tariffs;
- to publish its tariff charges.

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

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

The Authority is 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 shall 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) lets the Authority 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 on 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 national calls markets. This notwithstanding, the MCA feels that the proposed wholesale remedies 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 proposed below the objectives set out in Article 4 of the ECRA will not be attained.

The MCA considers that the market requires the imposition of the 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 proposed 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.

4.4.6 Measures to counter the charging of excessive pricing

Price- Cap

The MCA believes that Maltacom will likely continue to enjoy a strong position and a high market share in the retail markets within the timeframe of this review. As it is expected that there will be no significant challenge to Maltacom's dominance within the timeframe of this review there is an overriding case for action to ensure that Maltacom does not exploit its market position unfairly in the retail national calls markets to the disadvantage of consumers.

From the analysis carried out by the MCA, it is clear that competition in retail national calls markets has not developed yet. In light of this, the MCA is of the view that the wholesale obligations proposed, that is, Carrier Selection and Pre-Selection would not impose sufficient downward pressure on retail prices.

The view of the MCA is that some form of upper limit price control should be applied to retail call prices. Consequently, there is the necessity for regulation at the retail level in the markets for national calls and that this regulation should include price control in the form of a price cap mechanism. This is necessary in order to achieve and guarantee the objectives mentioned in Article 4 of the ECRA.

The MCA therefore intends to require Maltacom to comply with such a price control mechanism. Such an obligation should be maintained until markets are next reviewed for SMP designation and remedies by the MCA.

It is expected that the imposition of a price cap will be an adequate measure preventing excessive pricing until the desired level of competition occurs. The said obligation is expected to prevent overall consumer prices from rising above a specific amount, while allowing some necessary rebalancing of rental and call charges and also allowing further competition to develop. This should allow reasonable time for competition to develop sufficiently whilst maintaining incentives on Maltacom to improve efficiency.

In any event, the MCA will closely monitor developments in this market.

4.4.7 Countering measures that inhibit market entry or restrict competition

Cost-Orientation for Retail Prices

As mentioned above, in addition to the price cap obligation, 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. Moreover, the application to services that may fall outside the price cap would ascertain a wider coverage than a price-cap mechanism. The MCA therefore proposes that cost-orientation for retail prices should be maintained.

Cost Accounting

Regulation 37 of the ECNSR provides that an undertaking that is subject to retail tariff regulation or other relevant retail control, shall operate and maintain a cost accounting system, the format and accounting methodology of which may be specified by the MCA, 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.[13]

Furthermore, compliance by an undertaking with a 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.[14] The said undertaking 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.[15]

The MCA deems that accounting separation is also necessary in order for the SMP operator to fulfil its obligation of cost accounting and to allow the MCA to monitor the SMP operator'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.

4.4.8 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 that the Authority is proposing to be 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

[13] Regulation 37(5) and (6)

[14] ibid. subregulation 7

[15] ibid. subregulation 8

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.[16]

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.[17]

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 specifications18. 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.[19]

The MCA is of the view that the principle of transparency, Maltacom should continue to have the obligation to inform the MCA and publish any modifications to terms and conditions in particular tariffs, prior to their coming into effect. The required time spans are to be stipulated following a consultative process.

4.4.9 Measures to counter the unreasonable bundling of services

One of the major concerns of the MCA as guarantor of effective competition in the retail national calls 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 relevant 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.20

---

[16] Regulation 41(1) and Ninth Schedule of the ECNSR

[17] Regulation 41(2) of the ECNSR.

[18] 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.

[19] Article 22(4) of the ECRA.

[20] Regulation 30(1)(ii) of LN 151 of 2000.

In line with this approach, the MCA feels that it will benefit the competitiveness of the retail national calls 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 proposed 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 national calls markets.

Q4. Do you agree with the proposed obligations to be imposed on the identified SMP operator?

04.5 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 current and proposed obligations on the SMP operator identified earlier on, 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.

Chapter 05 – Submitting Comments

All comments are welcome; however it would make the task of analysing responses easier if comments were referenced to the relevant question numbers from this document. The consultation period will run from Friday 14th October to Friday 25th November 2005, during which the MCA welcomes written comments on any of the issues raised in this paper.

The MCA appreciates that many of the issues raised in this paper may require respondents to provide confidential information if their comments are to be meaningful. Respondents are requested to clearly identify confidential material and if possible to include it in a separate annex to the response.

Having analysed and considered the comments received, the MCA will review this analysis and publish a report on the consultation which will inter alia summarise the responses to the consultation.

In order to promote further openness and transparency the MCA will publish the names of all respondents. Moreover, in the interests of transparency, all representations will be published, except where respondents indicate that a response, or part of it, is confidential.[21] Respondents are therefore asked to separate out any confidential material into a confidential annex which is clearly identified as containing confidential material. The MCA will take steps to protect the confidentiality of all such material from the moment that it is received at MCA's offices. In the interests of transparency, respondents should avoid applying confidential markings wherever possible.

All responses must arrive at the MCA no later than 17.00pm of the 25th November 2005. Submission received after this time will not be taken into account.

All comments should be made in writing and where possible sent by email to info@mca.org.mt. However, copies may also be posted or faxed to the address below. If any parties are unable to respond in one of these ways, they should discuss alternatives with:

Chief Policy and Planning
Malta Communications Authority
''Il-Piazzetta'' Suite 43/44, Tower Road,
Sliema SLM 16
Malta
Europe
tel: +356 21 336840
fax: +356 21 336846

[21] In accordance with the MCA's confidentiality guidelines and procedures - http://www.mca.org.mt/library/show.asp?id=544&lc=1

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 *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.*	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 currency [22] 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 website

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.