

**Wholesale call origination, call termination and transit services
provided over fixed electronic communications networks**

**Identification and Analysis of Markets, Determination of
Market Power and Setting of SMP Conditions**

Consultation Document

14th October 2005

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Executive Summary

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

These 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's) proposal for identifying relevant markets and making market power determinations. Those likely to be effected may forward their comments within the period ending Friday 25th November 2005. Arrangements for submitting comments are explained in **Chapter 12**.

As required by Article 4 of the Electronic Communications (Regulations) (Article 7 of the Framework Directive), the MCA's proposals will be subsequently notified to the European Commission and to other NRAs.

Summary of Proposals

Identification of Markets

This review is split in three main parts. Part A deals with the market for wholesale call origination over fixed networks as identified in the Commission Recommendation on Relevant markets. The MCA has identified that this market includes all call origination services provided over all fixed networks which enable providers to supply retail fixed calls. More specifically, call origination incorporates conveyance from the network-end of the end-user's local loop through the switch directly connected to the end-user. In relation to these services the MCA is proposing to define the market as identified for by the Commission and therefore the **wholesale call origination market on fixed networks**.

In Part B of this document the MCA reviews the market for wholesale termination services provided over fixed networks. The MCA is proposing to define wholesale termination services as to include conveyance to the network-end of the end-user local loop through the switch directly connected to the end-user. The termination market is defined exactly as identified in the Commission recommendation. The MCA has identified two markets with respect to wholesale termination services; **i) wholesale termination services provided over Maltacom's network** and **ii) wholesale termination services provided over Melita Cable's network**.

Part C of this review deals with the provision of wholesale transit services in Malta. The MCA proposes to define the market for transit services to comprise the conveyance of traffic through at least one tandem switch not acting as a primary switch and including conveyance through International Switching Centres. Following its analysis the MCA concluded that national and international transit services should not fall within the same market and is

therefore proposing to define one market for **wholesale national transit services provided over fixed networks**, and another market for **wholesale international transit provided over fixed networks**.

The details of the definition of these markets, and the approach taken by the MCA when identifying these markets, are contained in **Chapters 3, 5 and 8** respectively.

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 to designate Maltacom plc. as having SMP in the market for wholesale call origination on fixed networks. The main criteria used to identify SMP include market share, economies of scale and scope, vertical integration and lack of countervailing buyer power.

In the wholesale call termination market the MCA concluded that all fixed network operators have SMP for termination services over their individual network. The MCA is proposing to designate Maltacom plc and Melita Cable as having SMP on their individual network for wholesale termination services. The MCA concludes that the lack of countervailing buying power and absolute market shares resulting from the Calling party pays principle, result in both operators having SMP.

In the analysis of the wholesale national and international transit markets the MCA concluded that due to the high market shares, economies of scale and scope and size of the undertaking, Maltacom plc. should be designated as having SMP in both markets. The MCA concluded that the relatively 'new' presence of Vodafone Malta Ltd. in the international transit market is not sufficient to be indicative of dominance and will not likely to be held as such during the timeframe of this review. Moreover, the MCA expects that during the timeframe of this review Maltacom plc. would not be expected to lose its market power through competition.

Full details of the MCA's proposed designations and reasoning are contained in **Chapters 4, 6 and 9** to this document.

Regulatory Implications

Given the position of dominance held by Maltacom plc. in the wholesale call origination, termination and national and international transit markets, voice call termination – i.e. its ability to behave to an appreciable extent independently of competitors, customers and ultimately consumers – the MCA proposes to impose on Maltacom plc. the following obligations:

- (a) Access to/and use of specific network facilities;
- (b) Non-discrimination;
- (c) Transparency;
- (d) Price control and Cost accounting; and
- (e) Accounting Separation.

All these obligations are applicable to Maltacom plc. in all the wholesale markets mentioned above.

The MCA has also identified other fixed network operators present in the market as having SMP in the wholesale call termination market on their individual networks. As a result the MCA is proposing to impose the following obligations on Melita Cable plc. :

- a) to meet reasonable requests for access to, and use of, such wholesale access products, features or additional associated facilities by undertakings requesting access or use of such access products, features or additional associated facilities, which form part of the market for wholesale call termination services used to provide retail calls to end-users on each public telephone network provided at a fixed location;
- b) to make public the termination rates and any proposed changes to such rates in advance of the change taking place; and
- c) to apply equivalent conditions in equivalent circumstances to other undertakings providing equivalent services, and provide services and information to others under the same conditions and of the same quality as it provides for their own services, or those of its subsidiaries or partners.

Full details of these remedies, including their effect and the reasons for proposing to set these conditions, are contained in **Chapters 5, 7 and 10** of this document.

Chapter 1 – 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 new 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 Electronic Communications (Regulation) Act, 2004 (hereinafter referred to “ECRA”) and the Electronic Communications Networks and Services (General) Regulations, 2004 (hereinafter referred to “ECNSR”). The Directive on Privacy establishes users’ rights with regard to the privacy of their communications was transposed into national legislation through the Processing of Personal Data (Electronic Communications Sector) Regulations of 2003 and the Electronic Communications (Personal Data and Protection of Privacy) Regulations of 2003

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

Each market review has three 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 entitled 'Market Review Methodology' outlining the methodology to be used for assessing effective competition in the Maltese electronic communications sector¹. The MCA is required to take these guidelines into utmost account when analysing a product or service market in order to access whether the market under investigation is effectively competitive or otherwise (refer to Regulation 8 of the ECNSR).

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

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

¹ Link to MCA 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 12**.

01.3 Liaison with Competition Authority

There is a requirement on the MCA under Regulation 10 of the ECNSR to carry out an analysis of a relevant market within the Electronic Communications sector. This analysis must be carried out in accordance, where appropriate, with an agreement with the National Competition Authorities (NCA) under Regulation 10 of the ECRA.

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

This review considers the markets for wholesale call origination, call termination and transit on fixed networks in Malta. The report is divided in three main sections dealing with each of these markets.

Q1. Do you agree with the scope of the MCA's review for wholesale fixed call origination, call termination and transit services market in Malta?

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 2 provides an overview of fixed networks in Malta and an initial delineation of market boundaries.

PART A - (Chapters 3,4,5) presents the MCA's preliminary conclusions on the definition of the markets for wholesale call origination on fixed networks in Malta. This section consists of a review of the market definition procedure and its scope, a detailed analysis of the market with the proposed SMP designations and the regulatory measures to be imposed on SMP operators.

PART B - (Chapters 6,7,8) deals with the proposed findings on the definition and analysis of the markets for wholesale call termination on individual fixed networks in Malta. This section consists of a review of the market definition procedure and its scope, a detailed analysis of the markets with the proposed SMP designations and the regulatory measures to be imposed on SMP operators.

PART C - (Chapters 9,10,11) illustrates the preliminary conclusions on the definition and analysis of the markets for wholesale transit services in Malta. This section consists of a review of the market definition procedure and its scope, a detailed analysis of the markets with the proposed SMP designations and the regulatory measures to be imposed on SMP operators.

Chapter 12 provides details with regard to the submission of comments on this consultation document.

Chapter 2 – Background to fixed telephone networks in Malta

As at December 2004 the total population of Malta stood at approximately 395,000. According to National Statistics Office figures there are approximately 128,000 residential households and 31,000 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 MCA³.

In Malta, the incumbent fixed telephony services operator - Maltacom plc⁴ - operates a PSTN network. The incumbent has over the past decade developed its ubiquitous network from one predominantly focused on fixed-line telephone services including international gateways, to one which incorporates other types of electronic communications services including; data communications (including internet and VoIP), mobile telephony and wireless.

Maltacom's infrastructure is made up of two International Switching Centres (ISC) and thirteen fully meshed switches at a lower level. While all the thirteen switches have access lines directly connected to them and therefore act as primary switches for their immediate areas, three of these switches are configured to function also as tandem switches for the conveyance of overflow traffic, Other Authorised Operators' (OAO) interconnection traffic and international traffic conveyance.

³ <http://www.mca.org.mt/library/show.asp?id=677&lc=1>

⁴ Hereinafter referred to as Maltacom

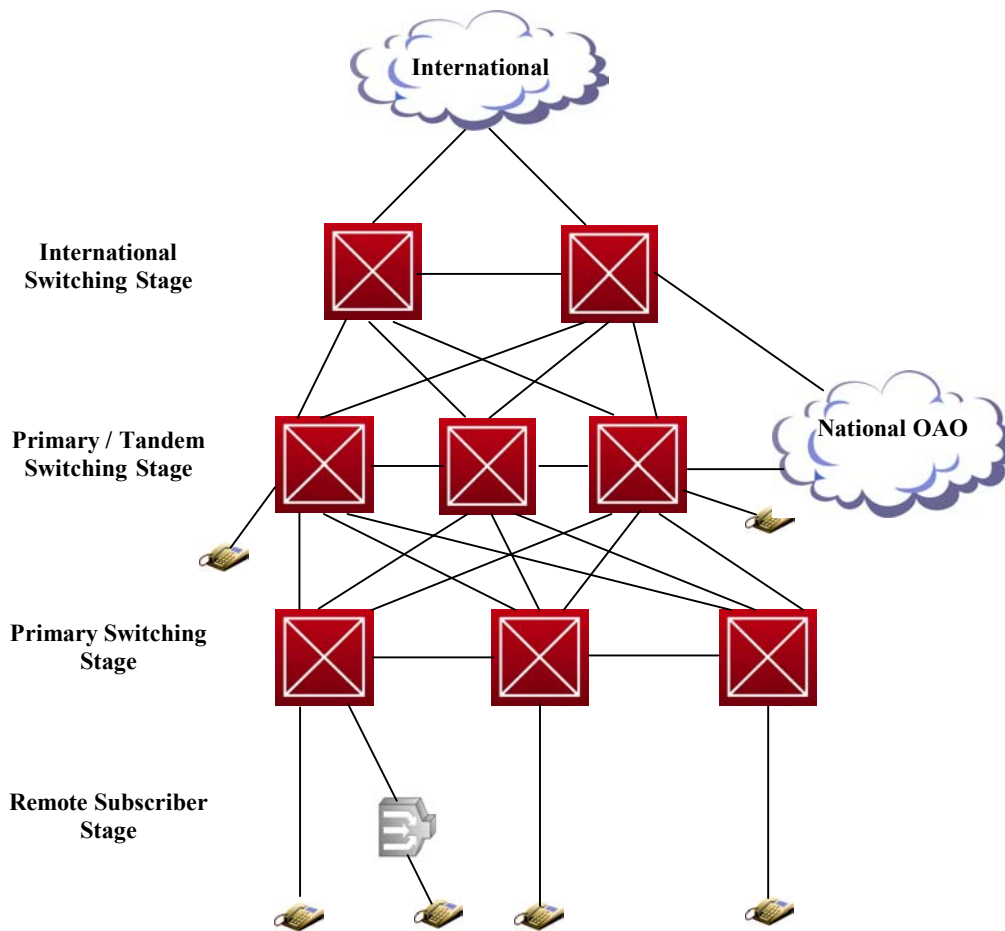


Diagram 1: Maltacom plc current fixed telephony network

This topology eliminates the need for OAOs to interconnect to each of the thirteen switches. Should the layout have not been such, OAOs would need to interconnect to all or the majority of switches to provide a quality service. This might not prove feasible given the 'limited' amount of landlines attached to each particular switch and that OAOs need to make sure that they have the minimum amount of traffic to warrant the investment.

A call originating on another network is, either carried from the interconnecting 'primary/tandem' switch directly to the end-user where the access line is connected directly to this switch, or conveyed to the switch to which the end-user number is associated. On-net calls are routed in a similar way. However, since all primary and 'primary/tandem' switches are connected, an on-net call to/from a particular access line may or may not include conveyance between 'primary/tandem' and primary switches.

While OAOs may interconnect to at least one of the three 'primary/tandem' switches mentioned above, they might also interconnect at a higher level to one or both ISCs to have their international calls conveyed as well.

Maltacom's network is expected to become less hierarchical with the upgrade of the present network as announced by the company. The soft-switch solution, which Maltacom is expected to adopt in the near future, will evolve their circuit-switched core network to a multi-service network capable of carrying voice, enhanced services and packet-based broadband traffic.

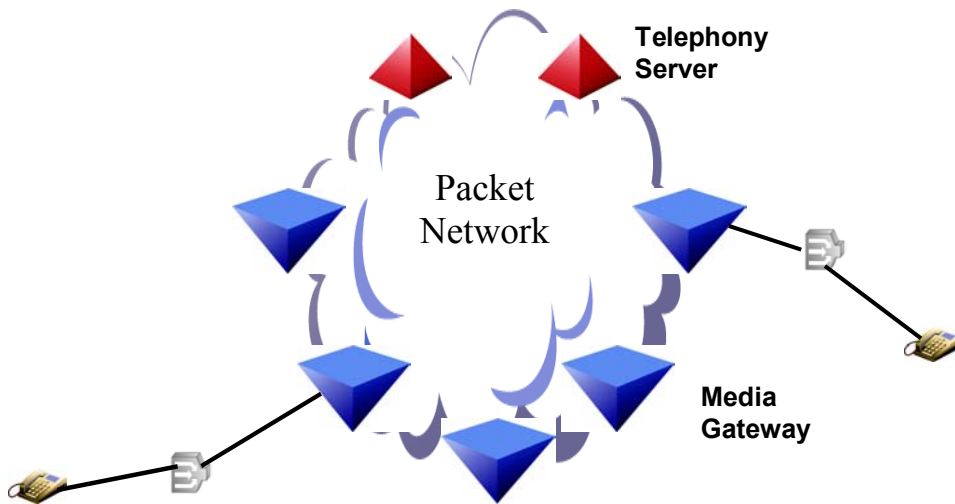


Diagram 2: Maltacom new network

Another infrastructure with almost ubiquitous coverage in Malta is the terrestrial 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 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, last July voice services over the cable infrastructure were introduced.

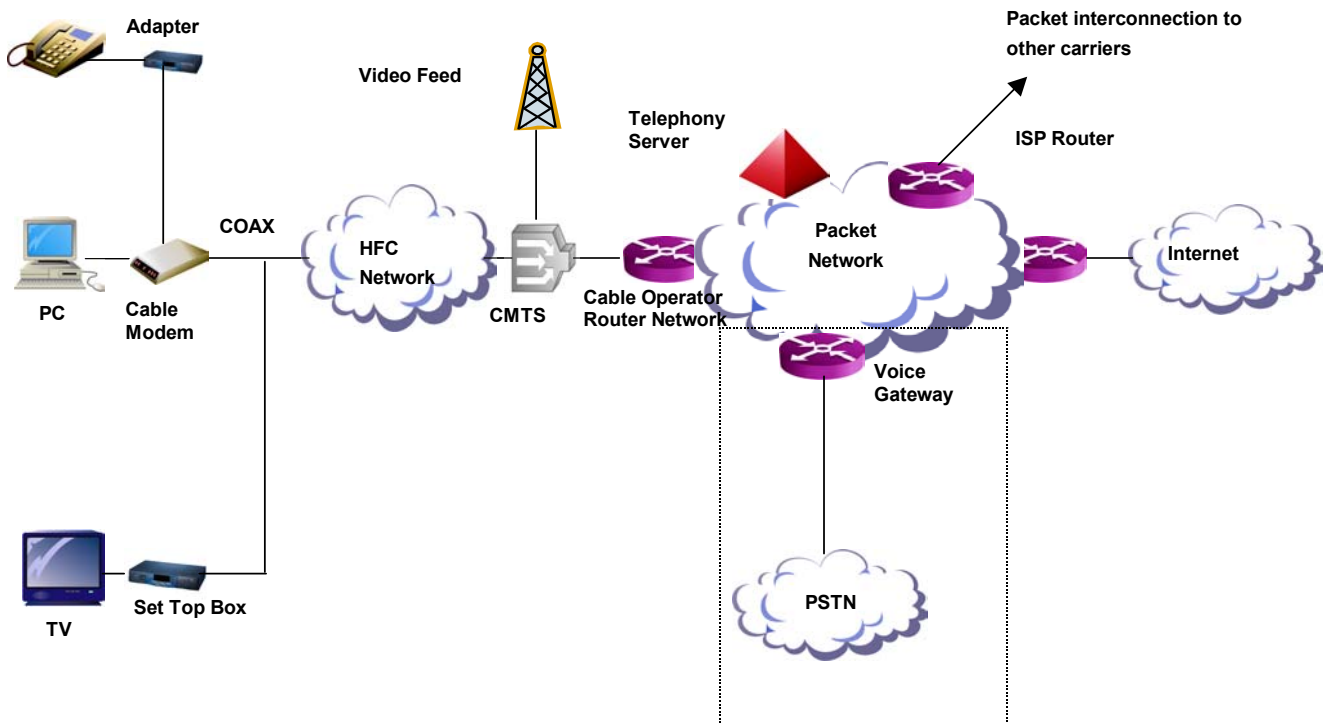


Diagram 3: Melita Cable plc network

Proposed Market Boundaries

The MCA proposes to functionally define the boundaries of the relevant markets for call origination, call termination and transit services as follows:

Call origination services on the public telephone network provided at fixed locations provide call setup, switching and connection for the initial stage of the call. They incorporate conveyance from an end-user to the network-end of the end-user's local loop through to the primary node (e.g. primary switch/ media gateway) prior to the next stage in the call routing (either call termination or transit).

⁵ Hereinafter referred to as Melita Cable

Call termination provides call completion and switching functionality at the terminating end of a call. It involves the conveyance of calls from the end of the previous stage in the call routing (either call origination or transit), through the primary node (e.g. primary switch/ media gateway) to the called end-user via the local-loop.

Transit services comprise the conveyance of traffic through at least one switching node (e.g. tandem switch/ media gateway) not acting as a primary connection to the end-user for the conveyance of a particular call⁶. This may include the conveyance of on-net calls, calls between the network and OAOs, all international calls (self-supplied or otherwise) and all calls handed over to the network by an originating operator to a third operator for termination.

The MCA is of the opinion that because a particular item of equipment may perform different functions in conveying different types of call types, transit services conveyance should be defined by reference to the routing of the call rather than the items of equipment used to route the particular call.

The market boundaries identified above would apply to Maltacom’s current network and also Next Generation Networks including Maltacom’s new network and Melita Cable’s network as shown below.

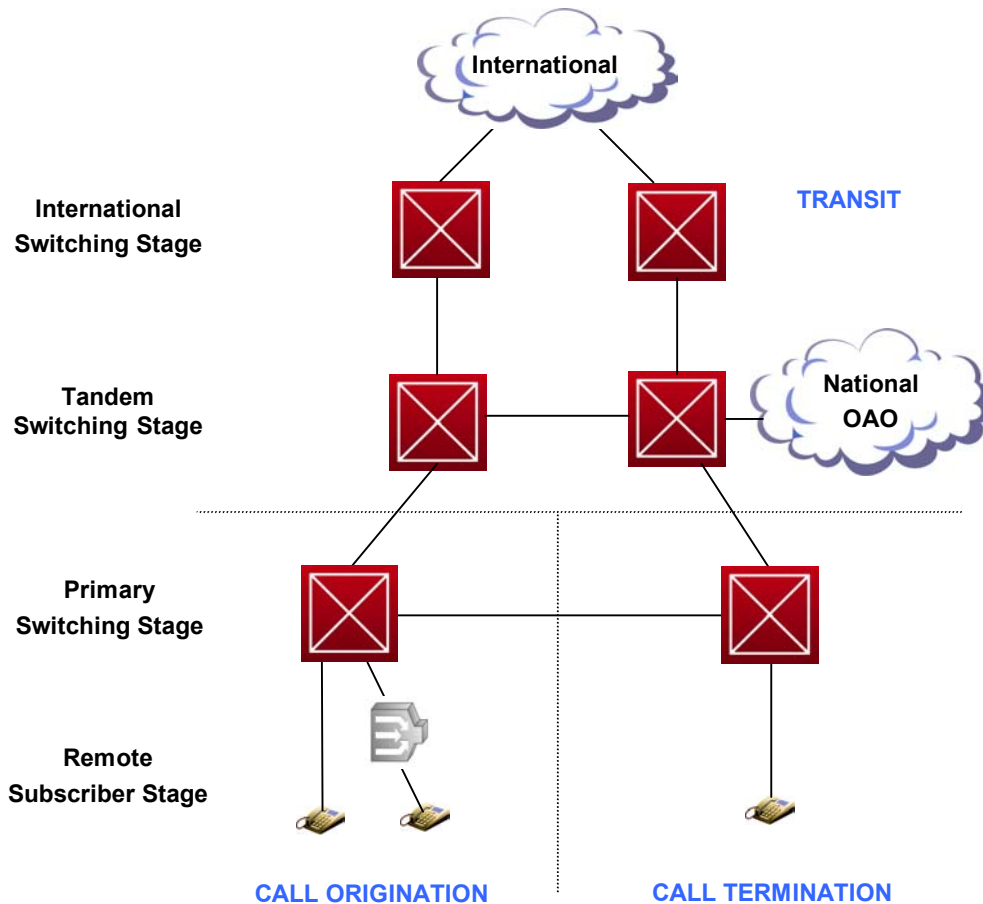


Diagram 4: POTS Market Boundaries

⁶ includes conveyance through the International Switching Centres

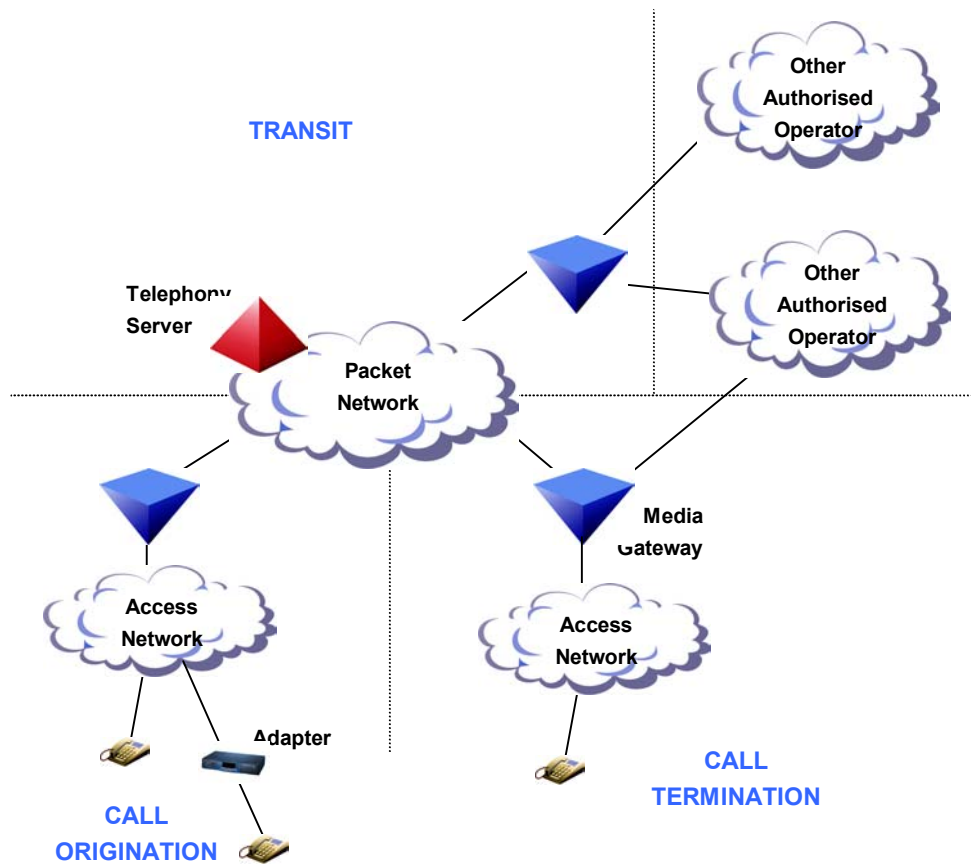


Diagram 5: Next Generation Network Market Boundaries

Further details on the proposed market boundaries are discussed in detail in the next sections.

PART A – WHOLESALE CALL ORIGINATION

Chapter 3 – Market Definition: Call Origination

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

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 Commission's 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 timeframe of this review, these changes are identified and discussed.

Paragraph 4 of the Recommendation states 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 is based on a Competition Law based assessment of markets 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.

In its recommendation the Commission identified three main wholesale markets for fixed networks. The Commission identified the wholesale call origination market as a relevant market for assessment by the NRAs, and it includes the originating access (in minutes or capacity) that enables providers to supply retail calls on the public fixed telephone network.

The MCA has conducted an assessment of the market for wholesale call origination on fixed networks in order to validate its appropriateness in the Maltese context, and as preparatory work for the assessment of SMP in this market.

03.1 Market Definition Process

The purpose of the market definition process is to identify the competitive constraints that electronic communications service providers face. There are two dimensions to the definition of a relevant market: the relevant products to be included in the same market and the geographic extent of the market. The MCA's approach to market definition follows that identified in MCA's market review methodology.

Recital (7) of the Recommendation clearly states that the starting point for market definition is a characterisation of the retail market over a given time horizon, taking into account the possibilities for demand and supply-side substitution. The wholesale market is then identified subsequently to this exercise being carried out in relation to the retail market. This approach is repeated in paragraph 3.1 of the main Recommendation and is exactly that followed by the MCA in the following sections.

Call origination services on the public telephone network provided at fixed locations provide call setup, switching and connection for the initial stage of the call. They incorporate conveyance from an end-user to the network-end of the end-user's local loop through to the primary node prior to the next stage in the call routing (either call termination or transit).

In Malta, the incumbent (Maltacom) is the main provider of fixed call origination services. At present, even though the incumbent offers call origination services in its Reference Interconnection Offer (RIO) no other operator has started using this service.

03.2 Retail Market

Since the demand for wholesale call origination services is derived from the demand for retail services, the MCA takes the view that the scope of the wholesale market definition is conditioned by the extent to which operators require origination services to be able to provide the relevant range of retail services. Therefore, the MCA has first considered the relevant retail markets and then analysed those at the wholesale level.

The demand for call origination stems from:

- Carrier selection and Carrier pre-selection related services, and
- the demand for call services by subscribers of access network operators.

The analysis of the retail markets in the document on *'National Telephone Services Provided At Fixed Location'*⁷, led to the view that service providers offering telephone services tend to offer end-users an entire range of call types. These would generally include calls to geographic numbers, calls to non-geographic numbers, international calls, internet calls and calls to mobile, as a cluster of services. The call origination services in this analysis are therefore being defined by reference to such retail telephone services provided at a fixed location.

In spite of this, unlike in the retail market where residential and business customers have different demand characteristics, wholesale call origination services provided to competing undertakings are the same regardless of whether they are being provided in relation to residential or business subscriber lines. This suggests that wholesale call origination for residential and business subscribers fall within the same market.

03.3 Wholesale Market

3.3.1 Wholesale demand side substitutability

As indicated above, call origination can either be self-supplied by a network operator to its own retail arm or provided by such a network operator to third parties. These third parties

⁷ Link to document: www.mca.org.mt

can be either CPS operators or terminating providers of non-geographic services (for example freephone services provided by alternative operators).

Only the operator with control over the end-user connection can provide call origination services. Therefore, undertakings wanting to acquire call origination services from such an operator are not able to substitute its service for that of another access network operator should the price of such services increase. An alternative operator wanting to provide CPS services to the customers of operator X cannot resort to call origination services from operator Y as a feasible substitute to call origination services of operator X.

An increase in the price of wholesale call origination would be passed on to the retail level unless the retail service provider absorbs the price increase itself. Such an increase would affect, both the retail arm of the network operator and third parties acquiring wholesale call origination, in the same way. This means that an operator raising its wholesale call origination charges would end up with either decreasing the profit margins of its retail arm or raise the prices of such retail services. This may act as a constraint to price increase.

Moreover, the calling party has the ability to choose its originating operator⁸ predominantly based on the level of pricing at the retail level. If the increase in retail costs to the calling party is significant, the subscriber will most likely switch retail service provider. The ability to switch to another originating access network operator imposes a pricing constraint on the wholesale call origination price offered by an access network operator.

One direct alternative to the purchase of wholesale call origination is to establish network access to the end-user location. A new entrant may decide to purchase or lease an established network connection to the end user location. This can be done by, for example renting local loops or acquiring leased lines. The MCA believes that neither of these alternatives is a suitable substitute for call origination. Such services are not functionally equivalent to wholesale call origination in that they provide dedicated access to the end-user. This is also reflected in their cost. While in the case of wholesale call origination the service provider pays only for the switched capacity, the acquisition of leased lines and unbundled local loops requires a substantial financial commitment. The MCA therefore considers it unlikely that service providers would promptly switch between wholesale call origination services and leased lines or unbundled local loops, in response to a 5 to 10% increase in price.

3.3.2 Wholesale supply side substitutability

In considering supply-side substitution, the key question to ask is whether a prospective supplier would enter the market in response to a small but significant increase in price of wholesale call origination by a hypothetical monopolist.

An extensive bi-directional cable infrastructure, which currently covers around 90 per cent of all households, has been operating since 1991. The cable operator is currently providing television streaming and broadband data services. After a recent upgrade to its infrastructure it has started to offer a voice over broadband (VoBB) call service product. This product enables users to make on-net and international calls only. To date the cable operator has not concluded any interconnection agreements with other network operators and therefore subscribers cannot make off-net local calls. Nevertheless, in the future the cable operator is

⁸ i.e. the retail arm of the network operator, a CPS operator, or another network operator offering access and call services

likely to interconnect with other local operators. It is therefore appropriate to consider call origination over the cable network to be in the same relevant market.

Another potential alternative access network is broadband wireless access networks (BWA). On the 12th October 2005 the MCA allocated frequency spectrum to three undertakings for the deployment of a national BWA network. The investment needed to roll out a nation wide BWA network is significant and a lengthy process.. The MCA believes that operators using broadband wireless technology are unlikely to have an impact during the timeframe of this review. In any case, the MCA is going to monitor closely the development of BWA services in Malta and will consider revising the market review if the market structure changes considerably.

03.4 Relevant Geographic Market

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

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

Based on these definitions and the market conditions described earlier on the MCA takes the view that the relevant geographic market for the provision of wholesale call origination services is national in scope. This view is supported by the fact that all fixed operators operate at a national level and do not differentiate their services in terms of pricing and availability between different geographic regions.

03.5 Conclusion on Preliminary Market

The MCA proposes to identify the relevant market for wholesale call origination as to include:

- wholesale call origination services provided to third parties, and
- self-supplied wholesale call origination services

provided over the PSTN or alternative fixed electronic communications networks.

Q2. Do you agree with the above preliminary conclusions regarding the market definition for the wholesale call origination market?

Chapter 4 - Market Analysis: Call Origination

Having identified the relevant market, the MCA is required to analyse the market in order to assess whether any services provider/s have significant market power as defined in Regulation 8 of the ECNSR (Article 14 of the Framework Directive). This section presents this analysis.

04.1 Method to Assess Significant Market Power

Under the EU Communications Directives and Article 4(8) of the ECRA, SMP has been 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.

04.2 Assessment of SMP Against Relevant Criteria

This section considers whether single dominance is likely to exist in the identified relevant market. 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. This analysis in the first instance considers the following key criteria: Market share analysis

- Barriers to entry
- Countervailing buyer power
- Vertical Integration
- Potential competition

4.2.1 Analysis of market shares

Although, high market shares are not in themselves decisive as to whether an undertaking enjoys SMP in a market, the MCA is of the opinion that market shares higher than 50 per cent would necessitate the 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 fixed telephony incumbent Maltacom was the only provider of fixed access and calls in Malta and was therefore the only provider that was present at both retail and wholesale level. Given this situation, Maltacom had a 100 per cent market share when calculated in both volumes and revenues in the wholesale fixed call origination market. Furthermore, Maltacom has an enduring absolute market share in this market which further reinforces the presumed finding of dominance.

In the prevailing decision, taken under the present regulatory regime, Maltacom has been designated to have a dominant market position in the public fixed telephony market which includes all fixed telephony services provided by the company⁹. Amongst the obligations already imposed, Maltacom was obliged to provide third party access for the provision of CS and CPS services. However, to date no such operators have started operations.

During July 2005, the cable operator which operates a nation wide network, launched a voice over broadband (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 2000. 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 the wholesale call origination market would be negatively impacted.

As a result, the current market structure dictates that Maltacom has significant market power in the provision of wholesale call origination services at a fixed location. The finding of dominance is further supported by the fact that Maltacom has an enduring high market share in this market. The MCA expects that this situation is likely to persist during the timeframe of this review.

⁹ <http://www.mca.org.mt/library/show.asp?id=100&lc=1>

4.2.2 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 has been the only operator providing fixed access and telephone services in Malta. Given the ubiquity and the high density of its network, Maltacom enjoys economies of scale in providing fixed access and call services. The per unit cost incurred by this undertaking for providing these services are therefore likely to be much lower than those of a new entrant. A new entrant would need to take a large share of the market if it is to effectively compete with the incumbent. In order to gain a large market share the new entrant will have to price below the incumbent's prices, which would make it very difficult for this operator to cover its costs.

Another area where economies of scale are likely to be achieved by Maltacom is in the supply of associated support services. As Maltacom provides a full range of services including access and calls, its per unit cost for providing associated services, like billing and maintenance costs would be much lower than the cost of a new entrant.

Economies of scope

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

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

The ability of Maltacom to benefit from such economies of scope are an indication that significant barriers to entry exist, and suggests that Maltacom will continue to enjoy SMP in the wholesale call origination market.

4.2.3 Vertical Integration

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

Maltacom is an integrated provider and operates at a wholesale and retail level in all the electronic communications market where it is present. The ability to lever market power from upstream to downstream markets may deter potential entry in these markets. An integrated provider can make it difficult for new entrants at a retail level to obtain the necessary inputs at a competitive price (i.e. cost based) and therefore create an entry barrier at retail level. Maltacom has to date leveraged its market power at the wholesale level into the retail market

by charging excessive wholesale prices. This has led to a situation where alternative operators could not enter the retail market profitably since wholesale rates were more expensive than the retail rates that Maltacom was charging its customers. The MCA believes that this situation is a clear reflection of the SMP that Maltacom enjoys at a wholesale level and this situation is likely to persist in absence of appropriate regulation.

4.2.4 Countervailing buyer power

The existence of customers with a strong negotiating position, which could be exercised to produce a significant impact on competition, will tend to restrict the ability of providers to act independently of their customers. 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 the only provider of a ubiquitous fixed telephone service in Malta and no alternative operator is currently purchasing wholesale call origination services from Maltacom. With the current market structure there is clearly lack of countervailing buyer power on Maltacom in setting wholesale call origination charges.

4.2.5 Potential Competition

Potential competition refers to the prospect of new undertakings entering the market within a short period of time and therefore possibly 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.

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 be in a position 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 VoIP/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 VoIP/VoBB services in Malta and will consider revising its conclusions if the market structure changes considerably.

04.3 Preliminary Conclusion and SMP designation

The evidence presented above indicates that Maltacom has significant market power in the wholesale call origination market.

This preliminary conclusion is supported by a number of factors including the very high market share (in excess of 95%) in the provision of fixed access lines and wholesale call origination services; Maltacom is a vertically integrated provider and has the ability to lever power from upstream to downstream markets; and the size of Maltacom makes it very difficult for a new entrant to attract a large number of customers during the timeframe of this review in order to gain sufficient economies of scale and scope in order to compete effectively.

Q3. Do you agree with the above preliminary conclusions regarding market analysis and proposed SMP designation for the wholesale call origination market?

Chapter 5 – Regulatory Implications: Call Origination

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.

In accordance with the Framework Directive, Regulation 10(4) of the ECNSR obliges the MCA, where an operator is designated as having significant market power in a relevant market in accordance with Regulation 8 of the same ECNSR, to impose, or amend if already imposed, the appropriate of the following obligations:

- Transparency (Regulation 18)
- Non-discrimination (Regulation 19)
- Accounting Separation (Regulation 20)
- Access to, and use of, specific network facilities (Regulation 21)
- Price control and Cost Accounting (Regulation 22)

In addition to the above, Regulation 17(3) of the ECNSR empowers the MCA, in exceptional circumstances, to propose the imposition of additional access or interconnection obligations on an operator with SMP. In doing so, the MCA is required to obtain authorisation from the European Commission prior to imposing said obligations.

Any obligations imposed by the MCA upon an operator with SMP in accordance with the above must:

- be based on the nature of the problem identified,
- be proportionate and justified in the light of the objectives laid down in article 4 of the ECRA; and
- only be imposed following consultation in accordance with article 10 of the ECRA and regulation 6 of the ECNSR.¹⁰

This section aims at discussing the actual and potential competition problems that exist in the wholesale call origination market, and proposing adequate remedies to address these problems.

05.1 Current Remedies

Under the previous regulatory framework the MCA has already identified Maltacom as having a dominant position in the provision of fixed telephony services. Maltacom had been designated as having a dominant market position in May 2002¹¹. Consequently the MCA has imposed on Maltacom the following remedies:

¹⁰ ECNSR, Regulation 17(4)

¹¹ <http://www.mca.org.mt/library/show.asp?id=100&lc=1>

- Ensure that the access or service provided meets certain specified quality of service standards, and to keep records and furnish to the MCA details of compliance with those performance standards;
- Interconnect promptly, publish a Reference Interconnection Offer (RIO) and ensure that charges for access / services are cost-orientated, transparent, unbundled and independent of the application to which they are put;
- Operate a cost accounting system which is suitable for implementation of the tariff requirements imposed on dominant operators and the calculation of charges for network elements used to provide interconnection; and
- Be subject to certain regulatory controls over retail tariffs as required by the Regulations.

All of the above obligations are still incumbent on Maltacom until a new decision based on the results of this market review will become effective.

05.2 Competition Problems in Fixed Markets

The MCA has identified a number of existing and potential SMP-related competition problems in the wholesale fixed markets under review. These are leveraging (vertical and horizontal), barriers to entry and price related problems.

5.2.1 Leveraging

Leveraging may be exercised by operators having SMP in two forms:

Vertical leveraging is the practice of a dominant firm that denies proper access to an essential input that it provides with the intent of extending its power from one segment of the market (the bottleneck segment) to the other (the potentially competitive segment). Such practice may be both price-related and otherwise.

The MCA believes that there exists the potential for vertical leveraging in all the three wholesale markets under review.

Maltacom, as a vertically integrated operator which is dominant in an upstream market may, unless prohibited by effective regulatory intervention, 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 undertakings competing at the downstream level, the said undertaking 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.

Over and above such price leveraging strategies, unless prohibited by effective regulation, Maltacom may be enticed to indulge into other forms of non-price leveraging such as, discriminatory use or withholding of information, delaying tactics, quality discrimination and the imposition of undue requirements on , and with respect to, alternative service providers.

Currently the wholesale rates which Maltacom applies are regulated and this has mitigated the aforementioned competition problems to a certain extent. The MCA considers that further regulation at wholesale level is essential in order to mitigate price related problems at both wholesale and retail level.

Horizontal leveraging involves the dominant undertaking using its position in one market to exert undue influence on other markets at the same level in the value chain. This form of leveraging can be exercised by Maltacom as it operates in a number of horizontal wholesale markets and can potential leverage its power from one market to another.

5.2.2 Entry deterrence, exploitative behaviour and productive inefficiencies

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

With reference to the market analysis above, the MCA notes that currently Maltacom enjoys a very high market share in the said wholesale fixed markets. Given the ubiquity and the high density of its network, Maltacom enjoys economies of scale in the provision of wholesale services.

Exploitative behaviour could take the form of measures taken to increase switching costs, exclusive dealing, and also predatory, excessive or discriminatory pricing. The MCA has intervened on a number of occasions to curtail as much as possible these competition problems. At present it is mandatory over Maltacom to have cost-oriented, transparent and non-discriminatory charges for their wholesale service.

05.3 Specific problems in the wholesale call origination market

The main impediment to competition within the wholesale call origination market is that it is particularly difficult to replicate Maltacom's network due to the large sunk costs associated with deploying such a network. As a consequence of this, an operator wishing to provide retail services to end-users of a fixed telephony access network, i.e. end-users of Maltacom, must either lease a direct connection from Maltacom via local loop unbundling or leased line and then self supply call origination, or make use of indirect access via carrier pre-selection and, or carrier selection. In the latter instance, the operator wishing to provide services to Maltacom's end-users, needs to purchase the wholesale origination services from Maltacom to the point of interconnection with its own network. The MCA has already established that the lease of lines through either local loop unbundling or leased lines are not suitable substitutes to wholesale call origination.

According to the Explanatory Memorandum to the Commission's Recommendation on relevant markets, the above situation gives rise to structural barriers since *'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'*. It is widely understood that, in such cases, effective competition is unlikely to emerge without proper regulatory intervention. Without such intervention, problems such as excessive and predatory pricing, foreclosure of the development of competitive downstream retail markets by virtue of a price squeeze and discrimination, as well as cross-subsidisation, remain a threat to the benefits which effective competition may have on the end-user.

Since it is not envisaged that during the timeframe of this review the market for wholesale call origination will become effectively competitive in order to bring the benefits of competition to the end-user and to reduce market failures associated with the foreclosure of retail markets, it is essential that competing operators can gain access to Maltacom's infrastructure. This implies that remedies should be imposed in order to provide alternative operators with essential wholesale inputs.

05.4 Selecting Remedies – Principles Applied

Given the identified actual and potential competition problems arising from SMP in the markets under review, the MCA is obliged to impose obligations on undertakings identified by it as having significant power on those markets. Accordingly, the MCA proposes to impose on undertakings with SMP those appropriate obligations that it believes will encourage efficient investment and innovation and further promote competition in the markets under review.

As discussed earlier, in selecting the remedies to impose on the designated SMP operator(s), the MCA considers the nature of the problem identified and, in accordance with the principle of proportionality, where necessary, imposes those remedies which it considers to be the least burdensome, yet effective, ones. The MCA also takes account of potential effects on any related markets. All this is reflected below.

Having said this, in view of the complexities of the competition problems discussed above, the MCA notes that it is unlikely that any single remedy can achieve the aim of ensuring effective competition. Hence, the need for a suite of remedies, as proposed below, that complement, support and reinforce each other.

05.5 Proposed Remedies

The MCA has identified Maltacom as having SMP in the wholesale call origination market. In order to curtail potential competition problems in this market, the MCA deems appropriate the imposition of remedies on the said undertaking.

The MCA is of the opinion that the remedies it is proposing to impose are based on the nature of the competition problems it has identified in the relevant market, 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 may issue further directions refining these remedies.

5.4.1 Access

As described above, due to Maltacom's SMP status in the wholesale call origination market, the placing of an effective access obligation on Maltacom is deemed necessary. Without the imposition of such an obligation, negative and anti-competitive effects are bound to be experienced in the retail markets. The MCA considers that the denial of access to third parties by Maltacom or the provision of access on unreasonable terms and conditions having a similar effect would hinder the emergence of a sustainable competitive market at the retail level and would not be in the end-user's interest.

This situation calls for the imposition of access obligations under Regulation 21 of the ECNSR. Hence, the MCA is empowered to require Maltacom, as the operator with SMP in the market under review:

- a) to give third parties access to specified network elements and, or facilities, including unbundled access to the local loop;
- b) to negotiate in good faith with undertakings requesting access;
- c) not to withdraw access to facilities already granted;

- d) to provide specified services on a wholesale basis for resale by third parties;
- e) to grant open access to technical interfaces, protocols or other key technologies that are indispensable for the interoperability of services or virtual network services;
- f) to provide co-location or other forms of facility sharing, including duct, building or mast sharing;
- g) to provide specified services needed to ensure interoperability of end-to-end services to users, including facilities for intelligent network services or roaming on mobile networks;
- h) to provide access to operational support systems or similar software systems necessary to ensure fair competition in the provision of services;
- i) to interconnect networks or network facilities.

When imposing the above access obligations, the MCA may attach to such obligations conditions of fairness, reasonableness and timeliness as required under Regulation 21(3) of the ECNSR.

This notwithstanding, in accordance with the principles of proportionality, when considering which of the above access obligations, if any, to impose, the MCA in accordance with Regulation 21(4) is required to take into account:

- (a) the technical and economic viability of using or installing competing facilities, in the light of the rate of market development, taking into account the nature and type of interconnection and access involved;
- (b) the feasibility of providing the access proposed, in relation to the capacity available;
- (c) the initial investment by the facility owner, bearing in mind the risks involved in making the investment;
- (d) the need to safeguard competition in the long term;
- (e) where appropriate, any relevant intellectual property rights; and
- (f) the provision of pan-European services.

By specifying that this access obligation is to be provided by Maltacom only upon a reasonable request being made by another undertaking, the law provides for the most proportionate means of applying the said obligation. In this way operators wishing to have access to Maltacom's wholesale call origination services could specify the particular access and, or interconnection arrangements that they require. The reasonableness or otherwise of the request should be evaluated on the basis of the above-cited Regulation 21(4) of the ECNSR and the decision to provide access or otherwise will be subject to scrutiny by the MCA in accordance with its powers at law where successful negotiations between the two parties fail.

In the light of the dominance enjoyed by Maltacom in the market under review, the MCA deems it appropriate that Maltacom is to provide the following obligations listed under Regulation 21(2) of the ECNSR upon a reasonable request being made by an undertaking.

Primarily Maltacom should retain its existing access obligations and not withdraw access to facilities already granted without prior authorisation in writing by the MCA. Moreover,

Maltacom should negotiate in good faith with undertakings making new requests for such access.

Maltacom should also interconnect its network or network facilities with undertakings making reasonable requests.

In order to ensure that other operators will be able to offer new products, the MCA considers it essential that Maltacom be obliged to provide access to its infrastructure also in terms of paragraphs (a) and (f) of the above-cited Regulation 21(2) of the ECNSR when such access is reasonably requested by other undertakings. Once again, in case of non-agreement between Maltacom and an undertaking requesting access, the MCA will intervene as arbiter in accordance with its powers at law.

The MCA further considers the availability of access to Maltacom's technical interfaces, protocols or other key technologies that are indispensable for the provision of the services by other undertakings necessary for the creation of a truly competitive environment. Hence, Maltacom shall be obliged to provide access in terms of paragraph (e) of Regulation 21(2) of the ECNSR, too.

Likewise, the provision by Maltacom of access to operational support systems or similar software systems necessary to ensure fair competition in the provision of services is deemed necessary by the MCA.

Finally, the need for Maltacom to provide other undertakings with services needed to ensure interoperability of end-to-end services to users is also highlighted.

All the above access obligations must be provided by Maltacom on terms and conditions which are fair, reasonable and timely and which do not differ from those on which the wholesale call origination service is provided by Maltacom to its retail arm, both with respect to standard and timeliness. Moreover, access to the wholesale call origination services should be provided unbundled.

In all cases where access or interconnection is to be provided upon a reasonable request being made, the MCA will be the final arbiter in deciding whether the request is truly reasonable or otherwise.

The MCA intervention is aimed at ensuring that no access is withdrawn unfairly and at the same time that no obligations are imposed unduly on Maltacom

The obligation of access, coupled with the obligation of transparency and in particular the publication of the RIO in accordance with what was stated above, should stultify the power of Maltacom, as an operator with SMP in the market under review, to exert on other operators competing with its downstream services at a retail level. This notwithstanding, accompanying obligation of price control and cost accounting are deemed necessary and in the interest of effective competition and the service provided to the end-user.

5.4.2 Transparency

Regulation 18 of the ECNSR authorises the MCA to impose transparency obligations on undertakings holding significant market power in relation to interconnection and, or access, by requiring such undertakings to make public specified information, such as accounting information, technical specifications, network characteristics, terms and conditions for supply and use, as well as prices.

Although possibly the least intrusive of remedies, the MCA believes that the imposition of the obligation of transparency would ensure that alternative operators have sufficient information on price and non-price terms and conditions together with clear processes to which they would not otherwise have access. Having said this, the MCA is also of the opinion that transparency alone will not help overcome the competition problems described above but is rather a necessary obligation that ought to be supplemented by other remedies.

The ECNSR¹² further state that where an operator with SMP has obligations of non-discrimination, the MCA may require it 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 MCA is able to impose changes to reference offers to give effect to the obligations imposed under the Act. The MCA may also specify the precise information to be made available, the level of detail required and the manner of publication.

Currently Maltacom is meeting its obligation¹³ to publish call origination pricing as part of its Reference Interconnection Offer (RIO)¹⁴. By virtue of the obligation of transparency which the MCA is proposing to impose on Maltacom, the said operator will be obliged to continue publishing reference offers related to call origination. Such offers are to be sufficiently unbundled, include pricing, terms and conditions and service level agreements as directed by the MCA.

In order to better overcome the competition problems discussed above, the MCA is of the opinion that Maltacom should continue to provide and publish appropriate manuals, order forms and processes for services, the details of which are to be determined on a case-by-case basis. The publication of other information may be requested by the MCA from time to time. Furthermore, the MCA is of the opinion that Maltacom should continue to provide itemised billing at the wholesale level.

The need to impose transparency obligations is felt in view of the need to ensure that Maltacom provides other operators with effective access to its wholesale inputs.

5.4.3 Non-discrimination

As explained above, where an SMP operator, such as 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 the firm's own retail activities. In particular, it is in the SMP operator's interest to charge competing providers higher prices for wholesale services than it charges its own retail activities. In doing so, the SMP operator increases the costs of competing providers, giving itself an unfair competitive advantage. Besides price related competition problems, an SMP operator may also resort to non-price anti-competitive tactics such as the 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.

¹² Regulation 18(2)

¹³ This was laid down in the MCA's 'Report on Consultation and Decision entitled 'Interconnection in the Maltese Telecommunications Sector' published in May 2003' <http://www.mca.org.mt/library/show.asp?id=423&lc=1>

¹⁴ <http://www.maltacom.com/interconnect/docs.aspx>

The principal remedy offered for the competition problems resulting from vertical foreclosure is that of non-discrimination in the provision of access and, or interconnection. In accordance with Regulation 19 of the ECNSR, Maltacom, as the vertically integrated provider, would be obliged to:

- a) apply equivalent conditions in equivalent circumstances to other undertakings providing equivalent services, and
- b) provide services and information to others under the same conditions and of the same quality as it provides for its own services, or those of its subsidiaries or partners.

The MCA believes that an obligation of non-discrimination, as a remedy under Regulation 19, provides the same ability to alternative operators to obtain wholesale call origination at the same price and conditions which would apply to Maltacom's own retail arm. Hence this obligation is deemed an essential tool for the curtailment of foreclosure practices.

The MCA deems it also important, that information gained by Maltacom as a result of its provision of call origination services to another operator is not used by its downstream arms in any manner as to favour its own operations.

In order to further strengthen the obligation of non-discrimination and its effects on the market, the MCA considers it necessary to apply the complementary obligations of transparency and accounting separation on Maltacom.

5.4.4 Price control and Cost Accounting

In competitive markets, the price of services is driven down to competitive levels by the the players 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 translate in terms of higher retail prices and alternative service providers being less able to compete in the retail market at the detriment of end-users.

As held above, the current market analysis indicates that the limited infrastructure competition in the wholesale call origination market may lead to Maltacom (as the operator with SMP) sustaining prices at an excessively high level, or applying a price squeeze, to the detriment of end-users.

Regulation 22 of the ECNSR authorises the imposition on the undertaking with SMP (in this case Maltacom) 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 is in itself deemed instrumental in supporting competition in the retail market to the benefit of end-users, whilst at the same time supporting the obligations of non-discrimination and transparency at a wholesale level.

In applying obligations relating to cost recovery or pricing, the MCA is obliged to ensure that any cost recovery mechanism or pricing methodology that is mandated serves to promote efficiency and sustainable competition as well as maximise consumer benefits.¹⁵

¹⁵ ECNSR, Reg. 22(2)

a) Cost Orientation

When imposing cost orientation as a remedy for SMP, NRAs are required to take account of prices available in comparable competitive markets¹⁶. On the other hand when considering the imposition of obligations of price control and cost accounting, they are to take into account the investment made by the operator and allow the operator a reasonable rate of return on adequate capital employed, taking into account the risks involved.

In view of the risk of excessive pricing being applied by Maltacom in the wholesale origination market, the MCA is of the opinion that the pricing methodology that may promote competition most efficiently is that of cost orientation. Cost orientation is already mandated on Maltacom by virtue of its dominant position designation under the previous framework. By mandating that interconnection and access to wholesale call origination services provided by Maltacom are cost oriented, the MCA believes that it would be in a position to ensure fair and efficient access to Maltacom's network and services.

Therefore, in view of Maltacom's SMP status in the market under review the MCA is of the opinion that Maltacom's current cost orientation obligation is to be maintained. In accordance with this, the MCA will pay careful attention to those costs which are shared amongst a number of products, as well as to ensuring that only efficiently incurred costs will feature in Maltacom's charges.

b) Cost accounting systems

The MCA believes that, in order to effectively promote competition and curb possible abuse of dominance in the wholesale call origination market a cost accounting system will be necessary to support cost orientation. It is therefore proposing to impose such obligation as a further remedy on Maltacom. The MCA does not consider that the imposition of a cost accounting obligation would constitute an unreasonable burden on Maltacom.

Such cost accounting system will provide the MCA with detailed information regarding Maltacom's service costs and ensure that fair, objective and transparent methodologies are followed by the operator in allocating costs to the proposed regulated services. Information from such a system will be used by the MCA to complement the application of other regulatory measures such as transparency and non-discrimination.

Maltacom is currently obliged to support such a system by virtue of a decision¹⁷ which has been in place for some time. The 2002 decision established that operators having a Dominant Market Position should implement cost-based accounting systems using a Fully Allocated Cost accounting methodology using a historic cost base. At that time the MCA had taken the view that this methodology was the most practical approach in the short term. However, mindful of the deficiencies inherent in a historic cost-based system, particularly the issue that legacy costs and inefficiencies should not be shifted to other competing operators through incorporation in a Reference Interconnection Offer, in the same Decision the MCA stated that it would review the need to move to a current cost regime during 2005. It has thus issued a consultative document¹⁸ that examines the various issues that are relevant to a

¹⁶ *ibid.*

¹⁷ Implementation of Cost Based Accounting Systems for the Telecommunications Sector - Report on Consultation and Decision - July 2002.

¹⁸ Current Cost Accounting Methodologies for the Electronic Communications Sector – July 2005

transition from a historic cost base to a current cost base. Up till the publication of this document the consultation deadline had not expired. Further guidance on the way forward on this issue will be published in the near future.

5.4.5 Accounting Separation

Accounting separation is instrumental in ensuring that the undertaking with SMP is not price discriminating between its retail arm and its competitors when providing access and origination at a wholesale level. By evidencing the wholesale and internal transfer prices of the products and services of the undertaking with SMP, accounting separation ensures that the prices charged by the SMP operator are non-discriminatory.

The obligation of accounting separation is also important in the disclosure of possible market failures such as cross-subsidisation and the application of margin squeeze by an undertaking with SMP.

In view of the above and of the fact that the MCA is herein proposing the imposition of the obligations of non-discrimination and transparency on Maltacom, the MCA feels that the imposition of a accounting separation obligation on the same Maltacom is appropriate. Currently Maltacom is subject to the accounting separation obligation described in the MCA decision on Accounting Separation¹⁹. This level of obligation shall be maintained until further consultation is deemed necessary.

Q4. Do you agree on the proposed set of remedies to be imposed on identified SMP operators?

05.6 Monitoring Market Developments

The MCA considers that it would be sensible to keep a 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 significant changing market conditions.

¹⁹ Accounting Separation and Publication of Financial Information for Telecommunications Operators - Report on Consultation and Decision of October 2002, as amended by <http://www.mca.org.mt/library/show.asp?id=323&lc=1>

PART B – WHOLESALE CALL TERMINATION

Chapter 6 – Market Definition: Call termination

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

In its recommendation the Commission identified three main wholesale markets for fixed networks. The Commission identified the wholesale call termination market as a relevant market for assessment by the NRAs, and it includes the terminating and interconnection services required by providers to end a particular call on a public fixed telephone network.

The MCA has conducted an assessment of the market for wholesale call termination on fixed networks in order to validate its appropriateness in the Maltese context, and as preparatory work for the assessment of SMP in this market.

06.1 Market Definition Process

The purpose of the market definition process is to identify the competitive constraints that electronic communications service providers face. There are two dimensions to the definition of a relevant market: the relevant products to be included in the same market and the geographic extent of the market. The MCA's approach to market definition follows that identified in MCA's market review methodology.

Recital (7) of the Recommendation clearly states that the starting point for market definition is a characterisation of the retail market over a given time horizon, taking into account the possibilities for demand and supply-side substitution. The wholesale market is then identified subsequently to this exercise being carried out in relation to the retail market. This approach is repeated in paragraph 3.1 of the main Recommendation and is exactly that followed by the MCA in the following sections.

Call termination provides call completion and switching functionality at the terminating end of a call. It involves the conveyance of calls from the end of the previous stage in the call routing (either call origination or transit), through the primary node to the called end-user via the local-loop.

There are evidently costs associated with the conveyance of calls between networks and the operator hosting the called party expects the originating operator to pay the network costs incurred to terminate the relevant call. This section considers the wholesale service required to terminate a call to a specific number on a particular fixed network.

06.2 Retail Market

Any call to a specific number will result in the call being delivered to the particular fixed telephone to which the dialled number is associated. As any telephone number is unique to a

particular subscriber's fixed location, the calling party will generally know to where and to whom the call is being made although s/he might not know the identity of the network provider hosting the called party. It is unlikely that the calling party has any influence over the called party's choice of network.

Operators tend to offer their subscribers an entire range of retail call services as a cluster, which do not in practice include fixed call termination as a separate service. Subscribers require the ability to communicate with other retail users irrespective of the network to which they are connected. As a result, operators need to interconnect to each other's networks in order to allow calls to be seamlessly conveyed between them and terminated to the called subscriber line. It therefore follows that the need for wholesale termination is driven by retail call services.

Besides being acquired by call originating network operators and Carrier Selection / Pre-Selection operators seeking to terminate fixed calls to called parties, wholesale call termination may also be self-supplied by network operators conveying on-net calls.

6.2.1 Demand-side substitution at the retail level

Retail prices can only impose a competitive constraint on wholesale termination rates if the retail party paying for the service can bypass the terminating network. In terms of retail fixed-to-fixed calls, there are no effective substitutes for the caller who wishes to call a given party's fixed number, but making that call. Calling someone other than the desired party is unlikely to be an adequate demand-side substitute.

A potential retail demand-side substitute to calling a party's fixed number would be calling the same party's mobile number. In its document entitled National Telephone Services Provided At Fixed Location the MCA examined the probability of retail users switching to mobile services to replace fixed-to-fixed calls. In its analysis, the MCA concluded that the cost of making a fixed-to-mobile call is significantly more expensive than making a fixed-to-fixed call, which implies that from a demand-side substitution perspective there is little possibility that consumers would opt to substitute fixed-to-fixed calls by fixed-to-mobile calls. The same conclusion was arrived at when mobile-to-mobile calls were considered. Such high retail calls-to-mobile tariffs reflect the higher mobile termination costs charged by mobile networks.

The lack of demand-side substitution suggests that the provision of calls to individual numbers may constitute separate markets in which a hypothetical monopolist could profitably increase its retail price to specific numbers above the competitive level. However, retail call providers are unlikely to possess sufficient information regarding the elasticity of demand for calls to individual numbers to allow them to price discriminate profitably according to individual called numbers. The same argument is valid also at the wholesale termination level. This common pricing constraint allows the broadening of the market so as to include the termination of all calls on a particular fixed network.

6.2.2 Supply-side substitution at the retail level

Following the above, since there are no alternatives for making a fixed call to a particular number, it is clear that even if a competitive retail market exists, the retail market is not able to exert any competitive constraint on the wholesale terminating market of a terminating operator. As a result supply side substitution at retail level is not possible following a 5-10 per cent increase in the price of wholesale termination rates. This is further substantiated in the following sections examining the wholesale level.

06.3 Wholesale Market

6.3.1 Wholesale demand side substitutability

The terminating network operator completes calls to the fixed points with which the called numbers are associated. As explained above, there are no alternatives for making a fixed-to-fixed call to a particular number and therefore, when purchasing wholesale call termination, an originating network provider will not find termination on a network other than the one its retail customer wishes to call to be an adequate substitute on the demand-side. A terminating operator raises its wholesale call termination charges to increase its revenues and also increases its competitors' costs.

Moreover, the 'calling party pays' payment flow used in end-to-end calling means that it is the calling party who bears the whole cost of a call. For every call made, the calling party pays the price of the retail call while the originating operator pays the associated wholesale call termination charge to the terminating operator. Such call termination cost is therefore reflected in the originating operator's retail price and it thus follows that an increase in the wholesale termination may lead to higher retail call prices.

Therefore, the lack of demand-side substitutes for terminating on a specific network together with the payment structure described above provide an incentive to the terminating operator to raise its call termination charges without competitive constraints. This suggests that termination on an individual network constitutes a separate relevant market.

6.3.2 Supply-side substitution at the wholesale level

In analysing supply-side substitution at wholesale level, the MCA has considered whether a hypothetical 5 to 10% increase in wholesale termination above the competitive price would attract new entrants in the call termination market in response.

As stated earlier due to the CPP system a network operator can only provide termination services on its own network. Therefore, if a hypothetical monopolist increases the price of its termination services, an alternative network operator would not be able to start providing termination services on the hypothetical monopolist network. The alternative operator can only increase its termination price to match that of the hypothetical monopolist. Given the present level of technology there is no possibility of any supply side substitution following a hypothetical price increase.

06.4 Relevant Geographic Market

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

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

Based on these definitions and the market conditions described earlier on the MCA takes the view that the relevant geographic market for the provision of wholesale call termination services by individual fixed network operators is national in scope.

This view is based primarily on the fact that, as each individual fixed network operator is considered to be a separate relevant product market for the provision of wholesale call termination services, the geographic scope reflects the extent of physical coverage that characterises each fixed network operator. Furthermore, each operator is licensed on a national basis and offers geographically uniform termination rates.

06.5 Conclusion on Preliminary Market

On the basis of the above considerations, the MCA has identified the following preliminary markets

1. Wholesale call termination services provided by Maltacom.
2. Wholesale call termination services provided by Melita Cable

Each relevant market includes call termination services provided by the individual network operators to third parties and also self-supplied.

Q5. Do you agree with the above preliminary conclusions regarding the market definition for the wholesale call termination market?

Chapter 7 - Market Analysis: Call Termination

Having identified the relevant market, the MCA is required to analyse the market in order to assess whether any services provider/s have significant market power as defined in Regulation 8 of the ECNSR (Article 14 of the Framework Directive). This section presents this analysis.

07.1 Assessment of SMP Against Relevant Criteria

This section considers whether single dominance is likely to exist in the identified relevant market. 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
- Countervailing buyer power
- Potential competition

7.1.1 Analysis of market shares

As discussed in the market definition section, call termination for a particular call can only be made on the particular network to which the called number belongs. As a result, each individual network constitutes a separate market for termination services. This implies that when an operator requires terminating a call on a particular fixed network, it can do so only if it purchases termination from that operator. As a result all network operators providing termination services have an implicit 100 per cent share both in volumes and revenues for termination services over their own network.

In absence of regulation, fixed network operators would have an incentive to set wholesale termination charges at above competitive levels, in order to maximise revenues and increase the cost of alternative operators for purchasing termination services. This would likely to be reflected in higher retail charges for end-users.

The fixed incumbent Maltacom is presently terminating all fixed calls to the PSTN network. Maltacom therefore has a 100 per cent market share for termination services over its PSTN network. The MCA believes that in absence of regulation Maltacom would have an incentive to maintain high termination rates in order to limit competition in the market for fixed call services. This incentive is augmented further when considering the size of Maltacom as opposed to a new entrant. Since Maltacom owns all fixed access lines to the PSTN, a new entrant would find it very difficult to gather a large number of customers to its own network in order to reduce significantly the size of Maltacom and its market power.

The cable network operator Melita Cable has recently launched a VoBB service over its nation-wide cable network. Even though, to date this service is limited to on-net calls, Melita Cable is nonetheless present in the wholesale termination market as it is terminating its own traffic on its network. When the cable operator interconnects with other networks it will have

to offer termination services to third party operators for termination over its network. The MCA is cognisant of the fact that the cable VoBB service is still in its infancy and therefore the volume of self-terminated minutes by Melita Cable over its network is currently minuscule compared to that of the fixed incumbent Maltacom. Nonetheless, Melita Cable has a 100 per cent market share for termination services over its cable network and therefore has significant market power.

The MCA concludes that all fixed network operators present in the market have a 100 per cent market share for termination services over their own network and therefore hold a position of significant market power.

7.1.2 Countervailing buyer power

Countervailing buyer power in the wholesale fixed termination market may arise where a large customer or group of customers impose a competitive constraint on the termination rate charged by an operator. This situation is possible if alternative operators have a feasible alternative to the termination offered by incumbents.

The MCA considers that in the absence of appropriate regulation the fixed telephony incumbent Maltacom will not face a competitive constraint from any other operator or group of customers in order to constrain wholesale termination rates. This understanding is based on three main factors a) technology barriers ,b) the calling party pays system and c) the size of the undertaking.

With the present technology a customer wishing to contact a person on a fixed line can only do so by calling a particular fixed number associated with a particular fixed network. The originating operator has therefore to terminate the fixed call on the particular network to which the called number belongs. The originating operator cannot successfully terminate the call of his subscriber by terminating that call on a different network other than the one to which the number is registered. This technological barrier limits the countervailing buyer power of any operator when purchasing termination rates from other operators. In order to ensure a seamless communication service for its subscribers an operator has to purchase termination from other operators at the rate that these operators charge. Given the lack of countervailing buyer power any operator providing termination services can potentially abuse from its dominant position on its own network and charge termination rates above competitive levels.

Under the calling party pays system the calling party pays for the cost of the call and not the receiving party. However, the calling party does not have a choice as to where s/he wants to terminate the call since it is the called party which subscribes to a particular network of his choice. This arrangement leads to a situation where operators have an incentive to charge high termination rates since the cost incurred in buying termination on their network will be incurred by rival operators and not by their customers. Operators have an incentive to set termination rates above competitive levels since it increases revenue streams from wholesale services and at the same time increase the costs of rival operators.

Based on this reasoning and the size of Maltacom in the provision of fixed telephony services in Malta, the MCA concludes that in the absence of regulation Maltacom would be in a position to set termination rates at uncompetitive levels which would be detrimental for alternative operators and their customers. The MCA also considers that other operators would also be in a position to set high termination rates since Maltacom needs to buy termination services from these operators in order to ensure a seamless communication

service for its customers. This gives alternative operators the ability to set termination rates above competitive levels which are likely to be reflected in higher retail tariffs for the customers of Maltacom.

7.1.3 Potential competition

Potential market entry in the wholesale termination market is expected from a number of alternative network operators notably the cable network operator and potentially three BWA network operators. The cable operator is already providing termination services to itself for its VoBB telephone service. The cable network covers approximately 90 per cent of all households and therefore has a potential nation-wide coverage. This cable VoBB service is currently an on-net service since the cable network is not interconnected with other networks. However, the MCA is aware that in the near future the cable operator is seeking to interconnect with other operators in order to ensure a seamless communication service to its customers. This would require that the cable operator would offer termination services to other networks. Such a development is expected within the timeframe of this review and therefore the MCA considers that the potential provision of termination services to third parties by the cable operator will have an impact in the wholesale termination market.

A similar situation is likely to happen in the future when the deployment of BWA networks is completed. In the future three new network operators are likely to seek interconnection agreements with the existing fixed and cable operators. This however is not likely to happen within the next two years since the deployment of BWA networks is a lengthy process. This will therefore not have a material impact during the timeframe of this review.

The MCA has considered the extent to which entry in the market by the cable operator will influence the termination rates of the existing fixed incumbent Maltacom. As argued earlier, technical barriers and the calling party pays principle makes the terminating network dominant over its own network and therefore the number of players present in the market has very little constraining behaviour on the setting of termination rates. Further to this, Melita Cable currently has an insignificant market share when compared to Maltacom in terms of subscribers and volumes of minutes terminated on its network. The MCA therefore considers that given these barriers and the size of Maltacom, the cable operator would not be in a position to constrain Maltacom's termination rates effectively.

Similarly, because of the technological barriers, the calling-party pays principle and an obligation to interconnect Maltacom will not be in a position to constrain Melita Cable or any other operator from setting termination rates above the competitive level. All fixed network operators will have to rely on the termination of each other to be able to terminate all calls of their subscribers.

The MCA therefore concludes that in the absence of regulation, network operators may have an incentive to set termination rates above competitive levels which are then likely to be reflected in higher retail charges to consumers.

07.2 Preliminary Conclusion and SMP designation

The evidence presented above suggests that Maltacom and Melita Cable have significant market power over their individual networks for the provision of wholesale termination services.

This preliminary conclusion is supported by a number of factors including the 100 per cent

market share held by each network operator in the provision of wholesale termination services over their respective networks. Moreover, the lack of potential competition and lack of countervailing buyer power in the markets due to technological barriers and the CPP standard, limit the competitive constraints on all network operators.

Q6. Do you agree with the above preliminary conclusions regarding market analysis and proposed SMP designations for the wholesale call termination markets?

Chapter 8 – Regulatory Implications: Call Termination

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.

In accordance with the Framework Directive, Regulation 10(4) of the ECNSR obliges the MCA, where an operator is designated as having significant market power in a relevant market in accordance with Regulation 8 of the same ECNSR, to impose, or amend if already imposed, the appropriate of the following obligations:

- Transparency (Regulation 18)
- Non-discrimination (Regulation 19)
- Accounting Separation (Regulation 20)
- Access to, and use of, specific network facilities (Regulation 21)
- Price control and Cost Accounting (Regulation 22)

In addition to the above, Regulation 17(3) of the ECNSR empowers the MCA, in exceptional circumstances, to propose the imposition of additional access or interconnection obligations on an operator with SMP. In doing so, the MCA is required to obtain authorisation from the European Commission prior to imposing said obligations.

Any obligations imposed by the MCA upon an operator with SMP in accordance with the above must:

- be based on the nature of the problem identified,
- be proportionate and justified in the light of the objectives laid down in article 4 of the ECRA; and
- only be imposed following consultation in accordance with article 10 of the ECRA and regulation 6 of the ECNSR.²⁰

This section aims at discussing the actual and potential competition problems that exist in the wholesale call termination market, and proposing adequate remedies to address these problems.

08.1 Current Remedies

Under the previous regulatory framework the MCA has already identified Maltacom as having a dominant position in the provision of fixed telephony services. Maltacom had been designated as having a dominant market position in May 2002²¹. Consequently the MCA has imposed on Maltacom the following remedies:

²⁰ ECNSR, Regulation 17(4)

²¹ <http://www.mca.org.mt/library/show.asp?id=100&lc=1>

- Ensure that the access or service provided meets certain specified quality of service standards, and to keep records and furnish to the MCA details of compliance with those performance standards;
- Interconnect promptly, publish a Reference Interconnection Offer (RIO) and ensure that charges for access / services are cost-orientated, transparent, unbundled and independent of the application to which they are put;
- Operate a cost accounting system which is suitable for implementation of the tariff requirements imposed on dominant operators and the calculation of charges for network elements used to provide interconnection; and
- Be subject to certain regulatory controls over retail tariffs as required by the Regulations.

Under the previous regulatory framework Melita Cable was found to be dominant in the cable television and radio services market. Since Melita Cable has only recently started providing calls over its network, it was not present in the fixed telephony markets under the old framework.

08.2 Competition Problems in Fixed Markets

The MCA has identified a number of existing and potential SMP-related competition problems in the wholesale fixed markets under review. These are leveraging (vertical and horizontal), barriers to entry and price related problems and other competition problems specific to call termination. These problems have already been discussed in detail in section 04.2 above.

8.2.1 Specific problems in the wholesale call termination market

As explained in the market analysis part above, every undertaking providing fixed termination to end-users is deemed to have SMP over its own network. This in itself provides a further competition problem in comparison with the markets for fixed origination and transit. This is due to the fact that all operators in the market may have an incentive to exercise their market power in a way that will hinder competition by other operators competing with their retail arm. This may be done by, for example, setting excessive prices for terminating calls onto their network. Two or more of such operators may also potentially tacitly collude and this would also result in high prices for termination.

Having said this, however, the market reality suggests that Maltacom would be in a more likely position to abuse of its market power. This is due to the fact that, as a result of its ubiquitous provision of termination services and its former monopolist position, both at a wholesale and retail level, Maltacom still enjoys the greater portion of termination of fixed calls. The MCA is of the opinion that it is improbable that this situation would change within the period of this review. Moreover, whereas Maltacom may be incentivised to hinder competition at retail level by rendering termination of calls from competitors' subscribers to its own subscribers difficult, the inverse will not apply equally well. In fact, if a new entrant were to charge excessive prices for wholesale call termination services on its network, its end-users are bound to experience less calls being made to them. Even further, if such alternative operators were to refuse to provide wholesale call termination services on its

network, no off-net calls will be made to its end-users. In both situations end-users would have little reason to be attracted to or remain with such alternative operator.

This imbalance in the ability to exert market power may also be reflected in other non-price abuses, such as the discriminatory use, or withholding of, information, delaying tactics and the application of undue requirements in interconnection.

In light of this, and in accordance with the principle of proportionality, the MCA opines that the imposition of a suite of remedies on all undertakings in this market, yet at a varying level depending on the ability to exert market power, as described above, enjoyed by the undertaking in question and the nature of the competition problems identified, is necessary.

08.3 Selecting Remedies – Principles Applied

Given the identified actual and potential competition problems arising from SMP in the markets under review, the MCA is obliged to impose obligations on undertakings identified by it as having significant power on those markets. Accordingly, the MCA proposes to impose on undertakings with SMP those appropriate obligations that it believes will encourage efficient investment and innovation and further promote competition in the markets under review.

In selecting the remedies to impose on the designated SMP operator(s), the MCA considers the nature of the problem identified and, in accordance with the principle of proportionality, where necessary, imposes those remedies which it considers to be the least burdensome, yet effective, ones. The MCA also takes account of potential effects on any related markets. All this is reflected below.

Having said this, in view of the complexities of the competition problems discussed above, the MCA notes that it is unlikely that any single remedy can achieve the aim of ensuring effective competition. Hence, the need for a suite of remedies, as proposed below, that complement, support and reinforce each other.

08.4 Proposed Remedies

The MCA believes that as a result of the individual SMP position held by Maltacom and Melita Cable in the wholesale call termination market over their respective networks, the imposition of remedies is required.

The MCA is of the opinion that the remedies it is proposing to impose are based on the nature of the competition problems it has identified in the relevant market, 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 may issue further directions refining these remedies.

8.4.1 Access

In view of their lesser degree of ability to exert market power, the MCA believes that alternative operators have little, if any, incentive to refuse access or interconnection to other operators in the market under review. This notwithstanding, the MCA believes it reasonable and adequate to require such alternative operators to meet reasonable requests for access to, and use of, such wholesale access products, features or additional associated facilities by

undertakings requesting access or use of such access products, features or additional associated facilities, which form part of the market for wholesale call termination services used to provide retail calls to end-users on each public telephone network provided at a fixed location.

On the other hand, Maltacom's greater ability to exert market power necessitates tougher access obligations being imposed on it. Without such obligations being imposed at a wholesale level, it is likely that anti-competitive effects will be experienced in the retail call markets.

Hence, in view of the above, the MCA is of the opinion that the imposition of the following obligations on Maltacom is necessary.

Primarily Maltacom should retain its existing obligations relating to access to termination services and not withdraw such access facilities without prior authorisation in writing by the MCA. Moreover, Maltacom should negotiate in good faith with undertakings making new requests for such access.

Maltacom should also interconnect its network or network facilities with undertakings making reasonable requests.

In order to ensure that other operators are able to offer new products, the MCA considers it essential that Maltacom be obliged to give third parties access to specified network elements in terms of paragraphs a) and f) of Regulation 21(2) of the ECNSR when this is reasonably requested by other undertakings. In case of non-agreement between Maltacom and an undertaking requesting access, the MCA will intervene as arbiter in accordance with its powers at law.

The MCA further considers the grant to open access to Maltacom's technical interfaces, protocols or other key technologies that are indispensable for these services by other undertakings necessary for the creation of a truly competitive environment.

Likewise, the provision by Maltacom of access to operational support systems or similar software systems necessary to ensure fair competition in the provision of services is deemed necessary by the MCA.

Finally, the need for Maltacom to provide other undertakings with services needed to ensure interoperability of end-to-end services to users is also highlighted.

All the above access obligations must be provided by Maltacom on terms and conditions which are fair, reasonable and timely and which do not differ from those on which the wholesale call termination service is provided by Maltacom to its retail arm, both with respect to standard and timeliness. Moreover, access to the wholesale call termination services should be provided unbundled.

In all cases where access or interconnection is to be provided upon a reasonable request being made, the MCA will be the final arbiter in deciding whether the request is truly reasonable or otherwise.

The MCA intervention is aimed at ensuring that no access is withdrawn unfairly and at the same time that no obligations are imposed unduly on Maltacom

8.4.2 Transparency

The obligation of transparency transpires from Regulation 18 of the ECNSR. This provision authorises the MCA to impose transparency obligations on undertakings holding significant market power in relation to interconnection and, or access (including wholesale call termination), by requiring such undertakings to make public specified information, such as accounting information, technical specifications, network characteristics, terms and conditions for supply and use, as well as prices.

In view of the limited ability of alternative operators to exert market power, the MCA is of the opinion that requiring such operators to render public their termination rates and proposed changes to such rates in advance of the change taking place is sufficient but essential to remedy the potential abuse of their market power.

Whereas the MCA considers it necessary to impose the same obligation on Maltacom it believes that the undertaking's greater ability to exert market power necessitates further safeguards of transparency. Hence, it is suggested that Maltacom should continue to publish a sufficiently unbundled reference offer for termination services in accordance with Regulation 18(2) of the ECNSR²². In this regard, the reference offer should be sufficiently unbundled so as to ensure that alternative operators 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 services level agreements and prices as directed by the MCA.

The implementation of this obligation may also require the publication of other information from time to time. The MCA retains the right to impose changes to reference offers to give effect to the obligations imposed under the Act.

Apart from the obligations relating to the RIO, the MCA is of the opinion that Maltacom should continue to provide itemised billing also at a wholesale level.

The MCA believes that the imposition of the above transparency obligations should help to curtail a possible abuse of market power by both Maltacom and any other alternative operator in the wholesale termination market. However, the MCA is also aware that without further obligations in place to complement this obligation of transparency, the effectiveness of said obligation will be greatly impaired.

8.4.3 Non-discrimination

The obligation of non-discrimination is another effective remedy with which to counter the possibility of abuse of market power by undertakings with SMP. This obligation extends to both price and non-price related competition problems which very often give rise to vertical foreclosure in the provision of access and, or interconnection.

The said remedy targets in particular the competition problem of vertical foreclosure. It has been stated that in the wholesale termination market every undertaking is deemed to have SMP, even though to different degrees. In view of this problem and of the fact that the benefit of the said remedy surpasses the level of burden it places upon the operators which implement it, the MCA deems it adequate to impose such obligation both on Maltacom as well as any other operator in the market under review.

²² refer to current RIO: <http://www.maltacom.com/interconnect/docs.aspx>

This implies that when providing termination services to other operators, all operators providing wholesale call termination services shall apply equivalent conditions in equivalent circumstances to other undertakings providing equivalent services, and provide services and information to others under the same conditions and of the same quality as it provides for their own services, or those of its subsidiaries or partners.

The MCA deems it also important that information gained by operators as a result of its provision of call termination services, is not used by downstream retail providers in any manner as to favour their own operations.

In order to further strengthen the obligations of non-discrimination and transparency, the MCA considers it is necessary to apply the complementary obligations of price control and cost accounting on Maltacom. The MCA believes that at this stage the limited ability of alternative operators to exert market power in relation to wholesale call termination services does not warrant these further obligations on such operators.

8.4.4 Price control and cost accounting

As was held above with respect to the call origination market, without some intervention in pricing, Maltacom is likely to charge excessive prices, in order to maximise both its profits and the costs of competing providers. Higher wholesale charges are likely to translate in terms of higher retail prices of competing undertakings and such undertakings being less able to compete in the retail market, and this to the detriment of end-users.

As explained above, the MCA takes the view that Maltacom's greater ability to exert market power and its incentive and ability to limit competition at retail level necessitates the imposition of price control and cost accounting mechanisms.

In this light it is deemed necessary and adequate to impose the following obligations on Maltacom:

a) Cost Orientation

In view of the risk of excessive pricing being applied by Maltacom in the wholesale termination market, the MCA is of the opinion that the pricing methodology that may promote competition most efficiently is that of cost orientation. Cost orientation is already mandated on Maltacom by virtue of its dominant position designation under the previous framework. By mandating that interconnection and access to wholesale call termination services provided by Maltacom are cost oriented, the MCA believes that it would be in a position to ensure fair and efficient access to Maltacom's network and services.

Therefore, in view of Maltacom's SMP status in the market under review the MCA is of the opinion that Maltacom's current cost orientation obligation is to be maintained. In accordance with this, the MCA will pay careful attention to those costs which are shared amongst a number of products, and ensure that costs charged will reflect the costs of an efficient operation..

b) Cost accounting systems

The MCA believes that, in order to effectively promote competition and curb possible abuse of dominance in the wholesale call termination market a cost accounting system will be necessary to support cost orientation. It is therefore proposing to impose such obligation as a

further remedy on Maltacom. The MCA does not consider that the imposition of a cost accounting obligation would constitute an unreasonable burden on Maltacom.

Such cost accounting system will provide the MCA with detailed information regarding Maltacom's service costs and ensure that fair, objective and transparent methodologies are followed by the operator in allocating costs to the proposed regulated services. Information from such system will be used by the MCA to complement the application of other regulatory measures such as transparency and non-discrimination.

Maltacom is currently obliged to support such a system by virtue of a decision²³ which has been in place for some time. The 2002 decision established that operators having a Dominant Market Position should implement a Fully Allocated Cost accounting system using a historic cost base. At that time the MCA had taken the view that this methodology was the most practical approach in the short term. However, mindful of the deficiencies inherent in a historic cost-based system, particularly the issue that legacy costs and inefficiencies should not be shifted to other competing operators through incorporation in a Reference Interconnection Offer, in the same Decision the MCA stated that it would review the need to move to a current cost regime during 2005. It has thus issued a consultative document²⁴ that examines the various issues that are relevant to a transition from a historic cost base to a current cost base. Up till the publication of this document the consultation deadline had not expired. Further guidance on the way forward on this issue will be published in the near future.

Although these obligations are deemed adequate, the MCA will nevertheless continue to monitor developments in the call termination market in an ongoing basis so as to relax the obligations in the eventuality that increased network competition is experienced.

8.4.5 Accounting separation

Accounting separation is instrumental in ensuring that the undertaking with SMP is not price-discriminating between its retail arm and its competitors when providing access and interconnection at a wholesale level. By evidencing the wholesale and internal transfer prices of the products and services of the undertaking with SMP, accounting separation ensures that the prices charged by the SMP operator are non-discriminatory.

The obligation of accounting separation is important in the disclosure of possible market failures such as cross-subsidisation and the application of margin squeeze by an undertaking with SMP.

In view of the above and of the fact that the MCA is herein proposing the imposition of the obligations of non-discrimination and transparency on Maltacom, the MCA feels that the imposition of a accounting separation obligation on Maltacom is appropriate. Currently Maltacom is subject to the accounting separation obligation described in the MCA decision on Accounting Separation²⁵. This level of obligation shall be maintained until further

²³ Implementation of Cost Based Accounting Systems for the Telecommunications Sector - Report on Consultation and Decision - July 2002.

²⁴ Current Cost Accounting Methodologies for the Electronic Communications Sector – July 2005

²⁵ Accounting Separation and Publication of Financial Information for Telecommunications Operators - Report on Consultation and Decision of October 2002, as amended <http://www.mca.org.mt/library/show.asp?id=323&lc=1>

consultation is deemed necessary.

08.5 Summary of obligations

Given the position of dominance held by Maltacom in the wholesale voice call market the MCA proposes to impose on Maltacom the following obligations:

1. Access to/and use of specific network facilities;
2. Non-discrimination;
3. Transparency;
4. Price control and Cost accounting; and
5. Accounting Separation.

The MCA has also identified Melita Cable as having SMP in the wholesale call termination market on their individual network. As a result the MCA is proposing to impose the following obligations on Melita Cable:

1. to meet reasonable requests for access to, and use of, such wholesale access products, features or additional associated facilities by undertakings requesting access or use of such access products, features or additional associated facilities, which form part of the market for wholesale call termination services used to provide retail calls to end-users on each public telephone network provided at a fixed location.
2. to make public the termination rates and any proposed changes to such rates in advance of the change taking place; and
3. to apply equivalent conditions in equivalent circumstances to other undertakings providing equivalent services, and provide services and information to others under the same conditions and of the same quality as it provides for their own services, or those of its subsidiaries or partners.

Q7. Do you agree on the proposed set of remedies to be imposed on identified SMP operators?

08.6 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.

PART C – WHOLESALE TRANSIT SERVICES

Chapter 9 – Market Definition: Transit Services

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

In its recommendation the Commission identified three main wholesale markets for fixed networks. The Commission identified the wholesale transit services market as a relevant market for assessment by the NRAs.

The MCA has conducted an assessment of the market for wholesale transit services in order to validate its appropriateness in the Maltese context, and as preparatory work for the assessment of SMP in this market.

09.1 Wholesale Transit Market

As described previously, the MCA proposes to functionally define the boundaries of the relevant markets for call origination and call termination to include conveyance from/to the network-end of the end-user's local loop through the switch directly connected to the end-user.

The MCA proposes to define transit services as comprising the conveyance of traffic through at least one switching node (e.g. tandem switch / media gateway) not acting as a primary connection to the end-user for the conveyance of a particular call²⁶. This may include the conveyance of on-net calls, calls between the network and OAOs, all international calls (self-supplied or otherwise) and all calls handed over to the network by an originating operator to a third operator for termination.

Possibly due to the small size of the islands (316 sq km), to the knowledge of the Authority, national transit services for the transit of traffic between operators with Maltacom acting as a third party transit provider have never been requested. In fact, three of the four existing telephone service providers, that is, Maltacom, Mobisle Communications Ltd and Vodafone Malta Ltd are directly interconnected with each other. Melital Cable plc is not yet interconnected to any one of these. It must be noted that since Maltacom owns a ubiquitous network, it is able to act as a transit intermediary should the interconnection between the two mobile operators fail or should a new entrant in the call services market, like Melita Cable plc, request transit services from Maltacom.

In defining the wholesale transit services market, the Authority has considered the following factors:

²⁶ includes conveyance through the International Switching Centres

1. The building of alternative fixed access networks as a substitute to wholesale transit services;
2. Leased lines as a substitute to wholesale transit services;
3. Direct interconnection as a substitute to wholesale transit services;
4. Wholesale transit provided over mobile networks is part of the market; and
5. Whether national transit and international transit are in the same market.

1. Whether building an alternative fixed access network can substitute wholesale transit services

A new entrant may opt to build its own infrastructure including the local loop to end-users in order to avoid purchasing wholesale transit services. This requires the construction of a ubiquitous fixed network. By doing so, its subscribers would be able to make calls to other subscribers on the same network.

Since there are no alternatives for conveying and terminating a particular fixed call to a specific location/number, the new entrant needs to replicate the extensive fixed access network of the incumbent and eventually attract enough subscribers to his own number ranges or through number porting. The operator would then need to use this network for self-provision of transit services.

The MCA considers that given the present limited demand for national transit services and the level of investment that would be needed to achieve the same extensive coverage as that of the incumbent, the construction of such network is highly unlikely within the timeframe of this review.

2. Whether wholesale leased lines can substitute wholesale transit services

The MCA has considered whether wholesale leased lines are a feasible substitute to wholesale transit services.

A wholesale leased line is a communications link between two points provided by a fixed network operator at fixed locations. Such a connection provides dedicated capacity between those two points. On the other hand, transit services are provided over a connection which is able to convey information that can be routed and carried to anywhere on the public switched telephone network. Transit services provide switching, routing and carriage for switched calls originating and terminating on the public telephone network. As a result leased lines are functionally different from transit services since a leased line is only limited to provide two-way conveyance between two points whereas transit services can convey information to more than one fixed point and to different OAOs.

A new entrant opting to acquire wholesale leased lines from a fixed network operator needs to establish such a connection with every telephone service operator it requires to convey traffic with. Moreover, the OAO would need to connect to every tandem switch of the fixed incumbent in order to be able to convey traffic to all the customers of the incumbent without the need of transit services. Such operator needs to ensure that it has the minimum volume of traffic on each particular point-to-point route to warrant such an investment.

The MCA believes that the functional differences between the two services coupled with the cost of installing the necessary leased lines infrastructure, it is unlikely that an OAO would

opt for wholesale leased lines following a hypothetical 5 to 10 per cent increase in the price of wholesale transit services.

The MCA therefore deems wholesale leased lines and wholesale transit services to be functionally different services and constitute separate markets.

3. Whether wholesale transit services can be substituted by direct interconnection

The MCA has also considered whether wholesale transit services and direct interconnection fall within the same relevant market.

Similar to leased lines, direct interconnection provides a dedicated direct link between two network operators. This time however since the physical connection is achieved by actually laying fibre-optic cable in the ground end-to-end - such a connection is permanent. A decision to switch to direct interconnection requires substantial commitment as well as a significant amount of investment, planning and time. The operator needs to ensure that it has the minimum volume of traffic to justify such commitment.

Since the MCA cannot compare the prices of the services being analysed, it cannot judge whether an increase in transit cost would prompt an operator to switch to use direct interconnection. However, as in the case of wholesale leased lines, a new entrant opting to directly interconnect needs to establish such a connection with every telephone service operator it requires to convey traffic to. The high level of investment required coupled with high entry barriers makes it unlikely that service providers would promptly shift to direct interconnection if wholesale transit services were to increase by a 5 to 10 per cent hypothetical price increase. Besides, the MCA is also doubtful as to whether the newly created capacity would be offered on a systematic basis as transit services to third parties.

The MCA therefore believes that direct interconnection is not in the same market as fixed wholesale switched transit services.

4. Whether wholesale transit services provided over mobile and fixed networks fall in the same relevant market

In its analysis, the MCA has also considered whether switched transit services provided over mobile networks to third parties are in the same market as switched transit services over fixed networks.

At present there are three public telephone operators that have decided to interconnect directly between themselves foregoing the need to make use of national transit services.

The two mobile operators have not, up till now, offered national transit services to third parties. Although these operators might be able to offer some kind of transit services, the MCA is doubtful whether these operators have the necessary spare capacity on their network. Mobile operators may need to upgrade their infrastructure to cope with such an offering. The MCA believes that within the lifetime of this review, mobile operators will not offer national transit services to third parties on a systematic basis given an increase in price for transit services by a hypothetical monopolist.

The MCA therefore considers that for the duration of this review national transit services provided over mobile networks constitute a distinct market from national transit services provided over fixed networks.

As stated earlier, Malta is primarily connected to mainland (Sicily) through two fibre cables owned by Maltacom and Vodafone respectively. As at July 2004 all three public telephone operators were conveying all the international traffic over Maltacom's international gateway. However, as from July 2004 Vodafone started operating an international gateway and started to convey its own international traffic over this infrastructure. Since the deployment of the new international gateway, a new entrant in the market would have a choice between conveying its international traffic over Maltacom or Vodafone's network. The MCA is informed that Vodafone has recently developed a public offer for wholesale transit services, however at the time of publication of this review no requests have been made to the company. The MCA considers that the international transit services provided by the mobile operator are similar to those offered by the fixed incumbent and therefore pose a realistic and already existent competitive constraint on Maltacom. The MCA is of the opinion that Vodafone has sufficient spare capacity over its international gateway to provide transit services to third parties. Moreover, this wholesale service is readily available to anyone interested in acquiring such services.

The MCA therefore concludes that international transit services provided by mobile companies and fixed networks are sufficiently similar to be considered as adequate substitutes and should therefore fall within the same relevant market.

5. Whether international transit services and national transit services fall within the same market

The MCA also considered whether international transit services constitute a separate service market from the relevant market for wholesale national transit services.. Functionally, international transit services entail the routing of a call to/from an international termination/origination point.

From a demand-side perspective, international transit services are acquired by national and foreign providers of international retail calls services. International transit services and national transit services are functionally different and a retail call service provider seeking to convey an international call would not be able to do so by acquiring national transit services as a substitute. Such service provider needs the call to be terminated to the end-user with which the called international number is associated. There are no alternatives for making an international call to a particular number.

From a supply-side substitution perspective, the investment needed to enter the market and start providing either the national transit services or the international transit is a significant one and it would take a considerable amount of time to plan and deploy such a network.

The MCA believes that during the timeframe of this review, a supplier of national transit services would not be able to enter the market for the supply of international transit services in response to a small but significant price increase. This applies also to a supplier of international transit services seeking to enter the market for the supply of national transit services.

The MCA therefore concludes that national transit services and international transit services are in separate product markets.

09.2 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 provision of wholesale transit services is national in scope.

09.3 Conclusion on Preliminary Market

The MCA is proposing to define the markets for wholesale transit service as follows:

- Wholesale market for the provision of national transit services; and
- Wholesale market for the provision of international transit services.

Each relevant market includes transit services provided by network operators to third parties and also self-supplied transit services.

Q8. Do you agree with the above preliminary conclusions regarding the market definition exercise for the wholesale national and international transit markets?

Chapter 10 - Market Analysis: Transit Services

Having identified the relevant market, the MCA is required to analyse the market in order to assess whether any services provider/s have significant market power as defined in Regulation 8 of the ECNSR (Article 14 of the Framework Directive). This section presents this analysis.

10.1 Assessment of SMP Against Relevant Criteria

This section considers whether single dominance is likely to exist in the identified relevant market. 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
- Countervailing buyer power
- Barriers to entry
- Size of the undertaking

10.1.1 Analysis of market shares

The analysis presented in the market definition chapter identified a market for the provision of wholesale national transit services and a separate market for the provision of wholesale international transit services.

National Transit

The wholesale national transit market is entirely dominated by Maltacom since it is only Maltacom that according to the market definition outlined above provides national transit services. At present transit costs charged by Maltacom are incorporated in the origination and termination charges, however as defined in this document transit services are defined separately and include any conveyance over at least one tandem switch not acting as a primary switch.

Since Maltacom is the only provider of national transit services it implies that it has a 100 per cent market share and therefore has significant market power. Moreover, this market share has been sustained for a number of years, which further reinforces the finding of dominance.

International Transit

There are currently two operators that are providing wholesale international transit services; Maltacom and Vodafone. Up till July 2004 Maltacom was the only provider of international transit services since it was the only operator that had an international gateway. Consequently, Maltacom had a 100 per cent market share in the provision of international transit services.

As from July 2004, Vodafone started to operate the second international gateway and started to transit its own international minutes over its infrastructure. Moreover, the MCA is informed that Vodafone has recently started to offer international transit services to third parties. However, as at the date of publication of this review the MCA is not aware that any third party operator is using this service from Vodafone.

From data available to the MCA the estimated market shares for the past three quarters are as follows:

	2004Q2	2004Q3	2004Q4	2005Q1	2005Q2
Vodafone	0%	28%	34%	31%	36%
Maltacom	100%	72%	66%	69%	64%

The trend in the market shares seems to be relatively stable and indicates that although in the last quarter of 2004 Vodafone have started to transit their own international traffic over their network, Maltacom still transits on average of 66 per cent of international traffic over its international gateway. This indicates that although the second international gateway has introduced an element of competition in the market, Maltacom has maintained a position of dominance.

The MCA therefore concludes that Maltacom has a market share much higher than 50 per cent and has significant market power in the provision of wholesale national and international transit markets respectively.

10.1.2 Countervailing buyer power

Countervailing buyer power in the provision of wholesale transit services markets may arise where a large customer or group of customers impose a competitive constraint on the transit rates charged by an operator. This situation is possible if alternative operators have a feasible alternative to the termination offered by incumbents.

Maltacom's retail activities make it the largest purchaser of transit services in the national and international transit services markets and therefore Maltacom is the only provider that could potentially exert countervailing buyer power in the purchase of transit services. However, the MCA is of the opinion that it is unlikely that Maltacom would use its market power to constrain its own prices.

Whilst in the national transit market Maltacom is the only provider with a 100 per cent market share, in the international transit market the entry of a second operator could potentially give alternative operators the ability to exert some level of countervailing buyer power on Maltacom. The MCA notes this possibility, however given the economies of scale and scope gained by Maltacom and the present limited demand for transit services, the MCA concludes that this possibility is not sufficient to constraint Maltacom.

The MCA considers that during the timeframe of this review there can be little or no countervailing buyer power in the provision of international and national transit markets respectively.

10.1.3 Ease of market entry

Maltacom has a ubiquitous fixed network and owns all the PSTN access lines in Malta. An alternative operator would therefore need to ensure that it is connected to Maltacom to enable its customers to receive and make calls to Maltacom subscribers. Moreover, the alternative operator would need to interconnect with every exchange of every other operator in order to avoid using national transit services from Maltacom. The MCA considers that this requires a significant investment and as the number of operators increase it is likely to be a less attractive option. Moreover, given the limited number of national transit minutes and the potential increase in the number of operators, it may not be feasible for an alternative operator to directly interconnect rather than purchasing transit services from Maltacom. Nonetheless, the MCA considers that in order to provide wholesale national transit services the alternative operator would need to have sufficient spare capacity and a ubiquitous coverage to be able to offer transit to third parties. The MCA feels that it is very unlikely that any other operator would find this a feasible option. As a result, the MCA is of the opinion that market entry in the provision of wholesale national transit services is restricted due to high entry barriers.

Due to the geographical position of Malta, international connectivity requires a huge capital investment. As at July 2004 the fixed incumbent Maltacom was the only operator that had the infrastructure to offer international transit services. However, as from July 2004 Vodafone started operating the second international gateway. Nevertheless, the MCA considers that the high investment involved in deploying the necessary infrastructure to ensure international connectivity is a significant barrier to entry for any other new entrant during the timeframe of this review.

The MCA concludes that both the national and international wholesale transit markets are subject to high barriers to entry and would therefore be very difficult for new entrants to replicate the existing infrastructures.

10.1.4 Economies of scale and scope

For operators to exploit economies of scale, they must be able to achieve a high utilisation of their interconnect links which is only possible with large volumes of traffic. Given that Maltacom owns all PSTN access lines in Malta, it is in a position to enjoy the benefits of economies of scale. An alternative operator would not have such a large volume of traffic and therefore gain economies of scale.

Due to the significant sunk costs involved, alternative operators would find it very difficult to match the size of Maltacom's ubiquitous network. In order to compete with Maltacom on price they would need to have sufficient scale to bring their overall costs below that of Maltacom. The MCA considers that alternative operators would not be in a position to ensure such a wide coverage and a sufficient traffic volume to effectively compete with Maltacom in the provision of wholesale transit services. Moreover, Maltacom provides a large number of services over its network and is therefore able to exploit economies of scope in the provision of its services. This further limits the possibility of alternative operators to effectively compete with the incumbent.

10.1.5 Overall size of the undertaking

Maltacom's network is ubiquitous including thirteen switches, two of which acting as tandem switches, and two international switching centres. All switches are fully meshed and therefore

ensure a high level of national and international connectivity. At retail level Maltacom enjoys a position of dominance in the provision of retail fixed calls and owns all PSTN access lines.

Moreover, Maltacom is a vertically integrated provider that is able to leverage its dominance from the origination market into the wholesale transit services market.

The size and ubiquity of Maltacom is a determining factor in ensuring that during the timeframe of this review it will continue to maintain its significant market power in the provision of wholesale transit services.

10.2 Preliminary Conclusion and SMP designation

The evidence presented above clearly suggests that Maltacom has significant market power in the wholesale national transit services market and in the wholesale international transit services market.

These preliminary conclusions are supported by a number of factors including the very high market share in the provision of national and international transit services. Maltacom is a vertically integrated provider and has the ability to lever power from the call origination market into the transit services market and the size of Maltacom makes its very difficult for a new entrant to attract a large number of customers and traffic in order to gain sufficient economies of scale and scope in order to compete effectively with the incumbent. Moreover, the markets for the provision of transit services are subject to high entry barriers.

Q9. Do you agree with the above preliminary conclusions regarding market analysis and proposed SMP designations in the two wholesale transit markets?

Chapter 11 – Regulatory Implications: Transit Services

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.

In accordance with the Framework Directive, Regulation 10(4) of the ECNSR obliges the MCA, where an operator is designated as having significant market power in a relevant market in accordance with Regulation 8 of the same ECNSR, to impose, or amend if already imposed, the appropriate of the following obligations:

- Transparency (Regulation 18)
- Non-discrimination (Regulation 19)
- Accounting Separation (Regulation 20)
- Access to, and use of, specific network facilities (Regulation 21)
- Price control and Cost Accounting (Regulation 22)

In addition to the above, Regulation 17(3) of the ECNSR empowers the MCA, in exceptional circumstances, to propose the imposition of additional access or interconnection obligations on an operator with SMP. In doing so, the MCA is required to obtain authorisation from the European Commission prior to imposing said obligations.

Any obligations imposed by the MCA upon an operator with SMP in accordance with the above must:

- be based on the nature of the problem identified,
- be proportionate and justified in the light of the objectives laid down in article 4 of the ECRA; and
- only be imposed following consultation in accordance with article 10 of the ECRA and regulation 6 of the ECNSR.²⁷

This section aims at discussing the actual and potential competition problems that exist in the wholesale national and international transit services markets, and proposing adequate remedies to address these problems.

11.1 Current Remedies

Under the previous regulatory framework the MCA has already identified Maltacom as having a dominant position in the provision of fixed telephony services. Maltacom had been

²⁷ ECNSR, Regulation 17(4)

designated as having a dominant market position in May 2002²⁸. Consequently the MCA has imposed on Maltacom the following remedies:

- Ensure that the access or service provided meets certain specified quality of service standards, and to keep records and furnish to the MCA details of compliance with those performance standards;
- Interconnect promptly, publish a Reference Interconnection Offer (RIO) and ensure that charges for access / services are cost-orientated, transparent, unbundled and independent of the application to which they are put;
- Operate a cost accounting system which is suitable for implementation of the tariff requirements imposed on dominant operators and the calculation of charges for network elements used to provide interconnection; and
- Be subject to certain regulatory controls over retail tariffs as required by the Regulations.

11.2 Competition Problems in Fixed Markets

The MCA has identified a number of existing and potential SMP-related competition problems in the wholesale fixed markets under review. These are leveraging (vertical and horizontal), barriers to entry and price related problems. These problems have been discussed under section 04.2 above.

11.3 Selecting Remedies – Principles Applied

Given the identified actual and potential competition problems arising from SMP in the markets under review, the MCA is obliged to impose obligations on undertakings identified by it as having significant power on those markets. Accordingly, the MCA proposes to impose on undertakings with SMP those appropriate obligations that it believes will encourage efficient investment and innovation and further promote competition in the markets under review.

In selecting the remedies to impose on the designated SMP operator(s), the MCA considers the nature of the problem identified and, in accordance with the principle of proportionality, where necessary, imposes those remedies which it considers to be the least burdensome, yet effective, ones. The MCA also takes account of potential effects on any related markets. All this is reflected below.

Having said this, in view of the complexities of the competition problems discussed above, the MCA notes that it is unlikely that any single remedy can achieve the aim of ensuring effective competition. Hence, the need for a suite of remedies, as proposed below, that complement, support and reinforce each other.

11.4 Proposed Remedies

The market definition above has identified two transit markets, one for International and another for National Transit Markets. Whereas Maltacom has been found to have a 100 per

²⁸ <http://www.mca.org.mt/library/show.asp?id=100&lc=1>

cent share of the national market it has only got 65 per cent of the international market. Notwithstanding this difference in market share, the MCA is of the opinion that the need to curtail possible abuses, both price-related and otherwise, of Maltacom's market power by means of *ex ante* obligations applies equally to both markets. Hence the need to impose the same remedies with respect to both markets arises.

The MCA is of the opinion that the remedies it is proposing to impose are based on the nature of the competition problems it has identified in the relevant market, 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 may issue further directions refining these remedies.

11.4.1 Access

As a result of Maltacom's SMP position in the wholesale transit markets it is justifiable to conclude that Maltacom would have an incentive to foreclose the market unless it is prohibited from doing so by *ex ante* regulatory intervention. In view of this, the placing of an effective access obligation on Maltacom is considered necessary. Without such an obligation, negative and anti-competitive effects are bound to be experienced in the retail markets. The MCA considers that the denial of access to third parties by Maltacom or the provision of access on unreasonable terms and conditions having a similar effect would hinder the emergence of a sustainable competitive market at the retail level to the detriment of end-users.

In view of this need to curb possible abuses of power by Maltacom powering the transit market, the MCA deems it justifiable and adequate to impose the following obligations on Maltacom:

Primarily Maltacom should retain its existing access obligations and not withdraw access to transit facilities already granted without prior authorisation in writing by the MCA. Moreover, Maltacom should negotiate in good faith with undertakings making new requests for access to such services.

Maltacom should also interconnect its network or network facilities with undertakings making reasonable requests.

In order to ensure that other operators will be able to offer new products, the MCA considers it essential that Maltacom be obliged to give third parties access to specified network elements and, or facilities, in terms of paragraphs a) and f) of Regulation 21(2) of the ECNSR when this is reasonably requested by other undertakings. In case of non-agreement between Maltacom and an undertaking requesting access, the MCA will intervene as arbiter in accordance with its powers at law.

The MCA further considers the grant of open access to Maltacom's technical interfaces, protocols or other key technologies that are indispensable for these services by other undertakings necessary for the creation of a truly competitive environment.

Likewise, the provision by Maltacom of access to operational support systems or similar software systems necessary to ensure fair competition in the provision of services is deemed necessary by the MCA.

Finally, the need for Maltacom to provide other undertakings with services needed to ensure interoperability of end-to-end services to users is also highlighted.

All the above access obligations must be provided by Maltacom on terms and conditions which are fair, reasonable and timely and which do not differ from those on which the wholesale transit service are provided by Maltacom to its retail arm, both with respect to standard and timeliness. Moreover, access to the wholesale transit services should be provided unbundled.

In all cases where access or interconnection is to be provided upon a reasonable request being made, the MCA will be the final arbiter in deciding whether the request is truly reasonable or otherwise.

The MCA intervention is aimed at ensuring that no access to transit services is withdrawn unfairly and at the same time that no obligations are imposed unduly on Maltacom

The obligation of access, coupled with the obligation of transparency and in particular the publication of the RIO in accordance with what was stated above, should stultify the power of Maltacom, as an operator with SMP in the market under review, to exert on other operators competing with its downstream services at a retail level. This notwithstanding, accompanying obligations of price control and cost accounting are deemed necessary and in the interest of effective competition and the service produced to the end-user.

11.4.2 Transparency

Maltacom is currently only obliged to publish its international transit rates in the RIO. A national transit rate offer for operators wishing to pass local traffic through Maltacom acting as a third party does not exist. This notwithstanding, current call origination and call termination rates incorporate the national transit costs as defined in this document. In accordance with what is being proposed in this market review the transit market is to be kept distinct from the other two wholesale markets of origination and termination.

Hence, it is being proposed that transit rates charged by Maltacom are to feature separately in the RIO. Maltacom will thus be obliged to publish a reference offer for transit services which shall be sufficiently unbundled so as to ensure that undertakings are not required to pay for other facilities which are not necessary for the provision of transit services. The transit offer shall include pricing, terms and conditions and service level agreements as directed by the MCA. The publication of other information may be requested by the MCA from time to time. Furthermore, the MCA is of the opinion that Maltacom should continue to provide itemised billing relating to wholesale transit services.

In view of Maltacom's significant market power in the wholesale transit market, the MCA also deems it adequate for Maltacom to be obliged to feature the transit services in the appropriate manuals, order forms and processes for services it is obliged to provide and publish. The details of such manuals, forms and processes are to be determined on a case-by-case basis.

Although effective, the MCA reiterates its belief that, if applied in isolation, the remedy of transparency would have little, if any, effect on the promotion and enhancement of effective competition in the wholesale transit market.

11.4.3 Non-discrimination

As has been explained above, where an SMP operator, such as Maltacom, is also a vertically integrated provider, it may have an incentive to provide wholesale services on terms and conditions that discriminate in favour of its own retail activities. The obligation of

non-discrimination tackles both price and non-price related competition problems.

By virtue of this obligation, in accordance with Regulation 19 of the ECNSR, Maltacom, as the vertically integrated provider, would be obliged to:

- a) apply equivalent conditions in equivalent circumstances to other undertakings providing equivalent services, and
- b) provide services and information to others under the same conditions and of the same quality as it provides for its own services, or those of its subsidiaries or partners.

The MCA believes that an obligation of non-discrimination, as a remedy under Regulation 19, provides the same ability to alternative operators to obtain call transit at the same price and conditions which would apply to Maltacom's own retail arm. Hence this obligation is deemed an essential tool for the curtailment of foreclosure practices.

The MCA deems it important, too, that information gained by Maltacom as a result of their provision of call transit services to another operator is not used by its downstream arm in any manner.

Hence, by virtue of this obligation alternative operators would be given the opportunity to obtain call transit services from Maltacom at the same price and conditions which would apply to Maltacom's own retail arm. Moreover, Maltacom would be inhibited from abusing of any information it would have gained from such alternative operators as a result of its SMP position.

In order to further strengthen the obligation of non-discrimination and its effects on the market, the MCA considers it is necessary to apply the complementary obligations of price control and cost accounting on Maltacom.

11.4.4 Price control and cost accounting

As held above, 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 translate in terms of higher retail prices and alternative operators being less able to compete in the retail market at the detriment of end-users.

As held above, the current market analysis indicates that the limited infrastructure competition in the wholesale transit markets may lead to Maltacom (as the operator with SMP) sustaining prices at an excessively high level, or applying a price squeeze, to the detriment of end-users.

Regulation 22 of the ECNSR authorises the imposition on the undertaking with SMP, in this case Maltacom, 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 is in itself deemed instrumental in supporting competition in the retail market to the benefit of end-users, whilst at the same time supporting the obligations of non-discrimination and transparency at a wholesale level.

In applying obligations relating to cost recovery or pricing, the MCA is obliged to ensure that any cost recovery mechanism or pricing methodology that is mandated serves to promote efficiency and sustainable competition as well as maximise consumer benefits.²⁹

a) Cost Orientation

In view of the risk of excessive pricing being applied by Maltacom in the wholesale transit markets, the MCA is of the opinion that the pricing methodology that may promote competition most efficiently cost orientation. Currently, as explained above, Maltacom's while national transit charges are bundled together with the origination and termination charges there is no rate for when Maltacom transits traffic as a third party. A change to this is however being proposed in this market analysis as explained above and the wholesale transit charge is to feature unbundled in the Maltacom's RIO. By mandating that the wholesale call transit services provided by Maltacom would be cost oriented, the MCA believes that it would be in a position to ensure fair and efficient access to Maltacom's network and services.

In accordance with this, the MCA will pay careful attention to those costs which are shared amongst a number of products, as well as to ensuring that only efficiently incurred costs will feature in Maltacom's transit charges.

b) Cost accounting systems

The MCA believes that, in order to effectively promote competition and curb possible abuse of dominance in the wholesale transit market a cost accounting system will be necessary to support cost orientation. It is therefore proposing to impose such obligation as a further remedy on Maltacom. The MCA does not consider that the imposition of a cost accounting obligation would constitute an unreasonable burden on Maltacom.

Such cost accounting system will provide the MCA with detailed information regarding Maltacom's service costs and ensure that fair, objective and transparent methodologies are followed by the operator in allocating costs to the proposed regulated services. Information from such system will be used by the MCA to complement the application of other regulatory measures such as transparency and non-discrimination.

Maltacom is currently obliged to support such a system by virtue of a decision³⁰ which has been in place for some time. The 2002 decision established that operators having a Dominant Market Position should implement cost-based accounting systems using a Fully Allocated Cost accounting methodology using a historic cost base. At that time the MCA had taken the view that this methodology was the most practical approach in the short term. However, mindful of the deficiencies inherent in a historic cost-based system, particularly the issue that legacy costs and inefficiencies should not be shifted to other competing operators through incorporation in a Reference Interconnection Offer, in the same Decision the MCA stated that it would review the need to move to a current cost regime during 2005. It has thus

²⁹ ECNSR, Reg. 22(2)

³⁰ Implementation of Cost Based Accounting Systems for the Telecommunications Sector - Report on Consultation and Decision - July 2002.

issued a consultative document³¹ that examines the various issues that are relevant to a transition from a historic cost base to a current cost base. Up till the publication of this document the consultation deadline had not expired. Further guidance on the way forward on this issue will be published in the near future.

11.4.5 Accounting separation

Accounting separation is instrumental in ensuring that the undertaking with SMP is not price-discriminating between its retail arm and its competitors when providing access and interconnection at a wholesale level. By evidencing the wholesale and internal transfer prices of the products and services of the undertaking with SMP, accounting separation ensures that the prices charged by the SMP operator are non-discriminatory.

The obligation of accounting separation is also important in the disclosure of possible market failures such as cross-subsidisation and the application of margin squeeze by an undertaking with SMP.

In view of the above and of the fact that the MCA is herein proposing the imposition of the obligations of non-discrimination and transparency on Maltacom, the MCA feels that the imposition of an accounting separation obligation on the same Maltacom is appropriate. Currently Maltacom is subject to the accounting separation obligation described in the MCA decision on Accounting Separation³². This level of obligation shall be maintained until further consultation is deemed necessary.

Q10. Do you agree on the proposed set of remedies to be imposed on identified SMP operators?

11.5 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.

³¹ Current Cost Accounting Methodologies for the Electronic Communications Sector – July 2005

³² Accounting Separation and Publication of Financial Information for Telecommunications Operators - Report on Consultation and Decision of October 2002, as amended by <http://www.mca.org.mt/library/show.asp?id=323&lc=1>

Chapter 12 – 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 some 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.³³ 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:

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³³ In accordance with the MCA's confidentiality guidelines and procedures - <http://www.mca.org.mt/library/show.asp?id=544&lc=1>