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Sabiedrisko Pakalpojumu
Regulēšanas Komisija (SPRK)

Brīvības ielā 55
LV-1010 Rīga
Latvia

For the attention of:
Mr Valdis Lokenbahs
Chairperson

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Dear Mr Lokenbahs,

Subject: Commission decision concerning Case LV/2014/1538: Modification of remedies on the markets for call termination on individual public telephone networks provided at a fixed location in Latvia

Opening of Phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC

Commission Decision concerning Case LV/2012/1539: Modification of remedies on the markets for call termination on individual mobile networks in Latvia

Comments pursuant to Article 7 of Directive 2002/21/EC as amended by Directive 2009/140/EC

I. PROCEDURE

On 2 January 2014, the Commission registered a notification from the Latvian national regulatory authority, Sabiedrisko Pakalpojumu Regulēšanas Komisija (SPRK)¹, concerning remedies on the markets for fixed call termination² and on the markets for

¹ Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive), OJ L 108, 24.4.2002, p. 33, as amended by Directive 2009/140/EC, OJ L 337, 18.12.2009, p. 37, and Regulation (EC) No 544/2009, OJ L 167, 29.6.2009, p. 12.

² Corresponding to market 3 in Commission Recommendation 2007/879/EC of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (Recommendation on Relevant Markets), OJ L 344, 28.12.2007, p. 65.

voice call termination on individual mobile networks³ in Latvia.

The national consultation⁴ ran from 9 October 2013 to 8 November 2013.

On 15 January 2014, a request for information⁵ was sent to SPRK and a response was received on 20 January 2014.

Pursuant to Article 7(3) of the Framework Directive, national regulatory authorities (NRAs), the Body of European Regulators for Electronic Communications (BEREC) and the Commission may make comments on notified draft measures to the NRA concerned. Pursuant to Article 7a(1) of the Framework Directive, the Commission may notify the national regulatory authority (NRA) and the Body of European Regulators for Electronic Communications (BEREC) of its reasons that the draft measure would create a barrier to the internal market or its serious doubts as to its compatibility with EU law.

II. DESCRIPTION OF THE DRAFT MEASURE

II.1. Background

1) Fixed Termination Rates

SPRK notified the third review of markets for fixed call termination in Latvia in 2011.⁶

Following the assessment of the proposed measures, the Commission reiterated its previous comments regarding the need for an appropriate price control using a cost methodology in line with the Termination Rates Recommendation.⁷

In July 2012 SPRK notified the modification of remedies on those markets.⁸ The assessment of this measure by the European Commission led to the opening of a phase II investigation.

The Commission expressed serious doubts given that the top-down fully distributed cost methodology proposed by SPRK to set FTRs did not ensure that termination rates are set on the basis of the costs of an efficient operator and, therefore, did not ensure the promotion of efficiency and sustainable competition and the maximisation of consumer benefits. Following the receipt of the Commission serious doubts, SPRK withdrew its notification of the draft measure on 17 August 2012.

2) Mobile Termination Rates

In 2012 SPRK notified the third review of the wholesale markets for voice call termination on individual mobile networks in Latvia. With regard to the lack of imposition of an access obligation, the Commission raised serious doubts as to the compatibility of the proposed measure with EU law and to enter a second phase

³ Corresponding to market 7 of Commission Recommendation 2007/879/EC of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communication networks and services, OJ L 344, 28.12.2007, p. 65.

⁴ In accordance with Article 6 of the Framework Directive.

⁵ In accordance with Article 5(2) of the Framework Directive.

⁶ Cf. case LV/2011/1199.

⁷ Commission Recommendation 2009/396/EC on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (Termination Rates Recommendation), OJL 124, 20.5.2009, p. 67.

⁸ Cf. case LV/2012/1355.

investigation under Article 7a of the Framework Directive. SPRK withdrew its draft measure on 27 April 2012.

In July 2012 SPRK re-notified its draft measure concerning these markets. SPRK proposed to designate all operators as having SMP in the markets for voice call termination on their respective mobile networks. SPRK proposed to set MTRs for all SMP operators on the basis of a benchmarking approach.

In its comments letter, the Commission invited SPRK to benchmark against all pure BU-LRIC MTRs currently implemented across the EU.

II.2. Regulatory remedies

The notified draft measures concern the modification of remedies (setting the price caps for termination services) with regard to the operators which have been previously designated as having SMP.

For the fixed and mobile call termination rates SPRK makes use of an approach based on benchmarking.

In the reply to the request for information SPRK indicated that this approach delivers outcomes consistent with the requirements of the Termination Rates Recommendation, even though the authority is currently not in a position to develop its own BU-LRIC model.

In the same reply SPRK also indicated that the analysis of data for the benchmarking was carried out until September 2013 including all countries that adopted termination rates based on a BU-LRIC methodology by that time.

1) Fixed Termination Rates

This is the first time that SPRK re-notifies draft measures relating to fixed call termination since they withdrew the previous notification in 2012. SPRK indicates in the public consultation document that the arithmetic average rate in those European Union countries that have submitted to the European Commission the proposals for fixed call termination rates, using a pure BU-LRIC cost model, is EUR 0.000785 per call minute.

SPRK proposes in the draft measure to fix, as of 1 July 2014, the ceiling of the fixed call termination rate, excluding value added tax, at a one-off fee of EUR 0.000845⁹ per call and EUR 0.000785 per call minute.¹⁰

2) Mobile Termination Rates

SPRK proposes in the draft measure to determine, as of 1 July 2014, the ceiling of the mobile call termination rate for all SMP operators, excluding value added tax, at EUR 0.0105 per call minute.¹¹

⁹ As stated by SPRK in the draft decision this value corresponds to a reduction of the rate per call, which is proportionately equal to the reduction that is taking place on the rate per minute determined by the use of benchmarking.

¹⁰ This represents a reduction as compared to the previously imposed rate of Euro 0.0097. SPRK indicated that the methodology currently used corresponds to a hybrid model combining an approach based on current cost accounting with benchmarking.

¹¹ This represents a reduction as compared to the rate of Euro 0.037 imposed until April 2013, and the rate of 0.0158 imposed as of 1 April 2013. SPRK indicated that the methodology currently used is a hybrid one combining current cost accounting and benchmarking.

The decision is based on the finding illustrated in the public consultation document that the arithmetic average of mobile call termination rates in European Union countries, that have adopted a pure BU-LRIC cost model, is EUR 0.0105.

With regard to both fixed and mobile termination rates SPRK proposes that the new rates become applicable as of 1 July 2014. SPRK indicates that the time period starting from the moment of the adoption of its final measure until 1 July 2014 is justified and proportionate to enable the undertakings to adapt to the new rates.

Moreover SPRK observes as well in the reply to the request for information that such a delay is necessary to comply with the consolidated administrative and legal practice in Latvia, and is justified by the need to promote regulatory predictability. SPRK underlines that the practice to notify the market players about important decisions at least 6 months in advance has been applied so far to all price cap decisions and other SMP-related measures. Therefore, any deviation from that established practice has a strong potential to be challenged before courts as discriminatory.

III. ASSESSMENT

The Commission has examined the notification and the additional information provided by SPRK and has the following comment:¹²

Developing a BU-LRIC model for Fixed and Mobile termination rates

The Commission notes that SPRK proposes to continue setting MTRs and FTRs on the basis of benchmarking.

As the Commission already indicated in its comments in case LV/2012/1356 and pursuant to recital (22) of the Termination Rates Recommendation, the benchmarking methodology for setting MTRs and FTRs, which mimics cost oriented prices, should only be imposed until a BU-LRIC cost model is ready for implementation and in principle exceptionally until 1 July 2014, and beyond that date only if objectively justified. The Commission believes that in order to better protect and promote the interests of consumers, businesses and operators, such model should be developed without further delay by SPRK.

The Commission therefore, taking into account the resources at the disposal of the SPRK and proportionality considerations, invites SPRK to develop its own BU-LRIC model as soon as possible in line with the Termination Rates Recommendation, if necessary requesting the support of BEREC or other regulators for this purpose.

Entry into force of pure BU-LRIC fixed and mobile Termination Rates

The Commission takes note of the fact that SPRK intends to implement price caps for fixed and mobile termination rates only as of 1st July 2014.

The Commission reminds SPRK that pursuant to the Termination Rates Recommendation NRAs should ensure that termination rates are implemented at a cost-efficient (pure BU-LRIC) level by 31 December 2012.

The Commission takes note of the reasons set out by SPRK (predictability and legal certainty), which, according to SPRK, justify the delay until 1 July 2014.

¹² In accordance with Article 7(3) of the Framework Directive.

The Commission considers that as a result of a Commission decision to open a Phase II investigation on SPRK's currently notified draft measure, SPRK will not be in a position to adopt the proposed measure for a minimum of an additional three months. This carries the risk of an even further delay of the adoption of the proposed termination rates. In order to avoid any further delay, the Commission requests SPRK to implement both fixed and mobile termination rates as soon as practically possible, and, in any event, not later than 1 July 2014.

Furthermore, following the examination of the notification and the additional information provided by SPRK, the Commission considers that the notified draft measures fall under the Commission's powers of ensuring the consistent application of remedies as set out in Article 7a of the Framework Directive, as the notified measures aim at imposing obligations on undertakings in conjunction with Articles 9 to 13 of the Access Directive.¹³

Draft measures imposing regulatory obligations on undertakings with SMP in Latvia may have an influence, direct or indirect, actual or potential, on the ability of undertakings established in other Member States to offer electronic communication services. SPRK's notification comprises measures that have a significant impact on operators or users in other Member States, inter alia measures which affect prices for users. Consequently, such draft measures may affect the patterns of trade between Member States.¹⁴

The Commission has serious doubts as to the compatibility with EU law of SPRK's draft measures concerning price control remedies for the wholesale markets for call termination on individual public telephone networks at fixed locations in its current form, in particular with the requirements referred to in Articles 8(4) and 13(2) of the Access Directive in conjunction with Article 8 of the Framework Directive and Article 16(4) of the Framework Directive. Furthermore, the Commission considers, at this stage, that the draft measures may create barriers to the internal market.

On the basis of the notification and the additional information provided by SPRK, the Commission has serious doubts in this regard for the following principal reasons:

Incorrect implementation of benchmarking with regard to FTRs

The Commission recommended to NRAs to ensure that termination rates are implemented at a (i) cost efficient, (ii) symmetric level (iii) and as of 31 December 2012. In the context of wholesale call termination markets, and given in particular their characteristics and the associated competitive and distributional concerns¹⁵, the cost efficient rate is normally the one resulting from a pure BU-LRIC methodology. This is because a BU-LRIC model both provides the correct

¹³ Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities, OJ L 108, 24.04.2002, p. 7, as amended by Directive 2009/140/EC, OJ L 337, 18.12.2009, p. 37.

¹⁴ See Recital 38 of the Framework Directive.

¹⁵ The accompanying Explanatory Note of the Commission Staff Working paper (SEC(2009) 600, 7.5.2009) sets out that due to the particular nature of the termination markets characterised on the one hand by "two-way" interconnection and on the other hand by monopolies in each relevant market (that create incentives for terminating operators to raise prices substantially above cost), cost-orientation obligations based on a BU-LRIC methodology are the most appropriate intervention to address productive- and allocative-efficiency concerns as well as maximise consumer welfare. As a result, in order to ensure compliance with the requirements of the regulatory framework, in particular Article 13(2) of the Access Directive (which states the requirement to promote efficiency and sustainable competition as well as maximise consumer benefits) NRAs shall apply a BU-LRIC cost model when setting termination rates.

cost signal to operators to increase efficiency and contributes to avoiding competitive distortions.

Whilst Article 19(2) of the Framework Directive provides NRAs the possibility not to follow a recommendation, in such circumstances they have to provide the reasons for such deviation. At the same time, any regulatory alternative approach chosen by the NRA to the one recommended by the Commission according to Article 19 of the Framework Directive has to comply with the other provisions of this Directive and the Specific Directives, in the present case, in particular Articles 8(4) and 13(2) of the Access Directive in conjunction with Article 8 and Article 16(4) of the Framework Directive.

A cost orientation remedy based on a pure BU-LRIC methodology best promotes competition by, among other things, ensuring that all users derive maximum benefit in terms of choice, price and quality, in line with Article 8(2) of the Framework Directive.

In this particular case, the notified measure does not appear to fully comply with the above principles and objectives set out in the Regulatory Framework.

The Commission notes that SPRK proposes to set FTRs on the basis of a benchmark against other Member States which apply the pure BU-LRIC methodology.¹⁶ However, the Commission notes also that SPRK decided to allow the fixed network operators to charge an additional fee (call set-up fee), which is added on top of the FTRs derived by means of benchmarking. In consequence of the addition of the set-up fee, SPRK significantly departs from the level of FTRs determined by other NRAs applying the recommended pure BU-LRIC cost model. Even though SPRK proposes a significant decrease of the fixed termination rates when compared to the current rates, the proposed rates are significantly above (approximately 26%)¹⁷ the average costs derived from the pure BU-LRIC benchmarking.

In this respect, the Commission points out that the addition of the call set-up fee over and above the average per minute FTRs does not ensure that rates are set on the basis of the costs of an efficient operator and therefore does not ensure that it will serve to promote efficiency and sustainable competition and maximise consumer benefits taking also into account prices available in comparative competitive markets, as required by Article 13(2) of the Access Directive. The proposed approach would also not be in line with Article 8(2) of the Framework Directive, which requires that NRAs should ensure that users derive maximum benefits in terms of price, choice and quality, and that there is no distortion or restriction of competition.

The Commission further considers at this stage that SPRK did not provide a sufficient justification showing that the methodology proposed would equally allow promoting efficiency and sustainable competition and maximise consumer benefits in line with the Regulatory Framework. Moreover, SPRK did not provide any justification for the additional fees over and above the benchmarked (average) pure BU-LRIC FTRs. In that regard the Commission notes that the

¹⁶ SPRK based its rate on the basis of the arithmetical average of the rates calculated by the NRAs in the following Member States: France, Italy, Malta, Slovakia, Ireland, The Netherlands.

¹⁷ This figure has been calculated based on a comparison of the FTR cost associated with a three minutes phone call in all countries used by SPRK for the purposes of benchmarking. The assumed average call duration of three minutes is also used by BEREC in their comparative reports.

application of two part tariff, consisting of a fixed fee (call set-up) and variable part (per minute fee) is not uncommon in relation to the fixed termination services. Nevertheless SPRK should have ensured that the total costs of call termination in the fixed networks in Latvia correspond to the pure BU-LRIC costs in the benchmarked Member States, and not only a part of it.

In consequence, the FTRs proposed in the notified draft measure clearly exceed the rates set by those countries, which have already implemented a pure BU-LRIC cost model.

On the basis of the above, the Commission considers that SPRK departs substantially from the pure BU-LRIC methodology without providing a sufficient economic justification showing that the alternative methodology proposed by SPRK would ensure compliance with the provisions of the Regulatory Framework, in particular with the objectives provided in Article 8 of the Framework Directive.

The Commission therefore considers, at this stage, that the result of the benchmarking undertaken by SPRK is not consistent with those of competitive markets, exceeding the average of the termination rates set by NRAs implementing the most efficient cost methodology, by a large margin. Indeed, in the present case, SPRK did not show that the proposed cost methodology would equally allow achieving the policy objectives and regulatory principles set out in Article 8 of the Framework Directive, and did not take account of prices available in comparable competitive markets in line with Article 13(2) of the Access Directive.

The Commission therefore has serious doubts that the proposed FTRs would be compatible with Articles 8(4) and 13(2) of the Access Directive in conjunction with Articles 8 and 16(4) of the Framework Directive. Hence, the Commission would like to express serious doubts that SPRK's proposal on FTRs is appropriate in the given termination markets within the meaning of Article 16(4) of the Framework Directive and justified in light of the objectives laid down in Article 8 of the Framework Directive, and in particular the objectives of promoting competition and user benefits pursuant to Article 8(2) of the Framework Directive.

Creation of barriers to the internal market

Due to the methodological flaws of the benchmarking, the proposed FTRs will remain for undetermined period of time significantly higher in Latvia than the average FTRs set in those Member States which set the rates on the basis of pure BU-LRIC model.

Any such considerable differences in fixed termination rates within the EU not only distort and restrict competition but have a significant detrimental effect on the development of the internal market, i.e. create a considerable barrier to the single market, and, therefore, result in a violation of the principles and objectives of Article 8(2) and (3) of the Framework Directive. A harmonised approach in setting fixed termination rates is particularly important to ensure that regulators do not favour their national operators at the expense of operators in other Member States by not introducing fully cost-oriented termination rates. It is exactly for that reason that the Commission has adopted the Termination Rates Recommendation to ensure a harmonised application of the Regulatory Framework in order to contribute to the development of the internal market and further the objectives set out in Article 8 of the Framework Directive.

In light of the above considerations, the Commission considers, at this stage, that the draft measure would create barriers to the internal market.

Conclusion

In this particular case, the Commission observes that SPRK's notification concerning the FTRs which are not based on a benchmark against the rates calculated on the basis of a pure BU-LRIC cost-model does not meet the policy objectives and regulatory principles enshrined in Article 8 of the Framework Directive, and can be considered to be in line with Article 8(4) of the Access Directive. Moreover, the methodological flaws in the application of benchmarking do not lead to FTRs which are consistent with the average of the rates as calculated on the basis of pure BU-LRIC cost models in other Member States.

Hence, the Commission has serious doubts that SPRK's proposal on fixed termination rates can be considered appropriate in the given termination markets within the meaning of Article 16(4) of the Framework Directive and justified in light of the objectives laid down in Article 8 of the Framework Directive, particularly the objectives of promoting competition and user benefits pursuant to Article 8(2) of the Framework Directive and believes, at this stage, that the draft measure would create barriers to the internal market.

The above assessment reflects the Commission's preliminary position on this particular notification, and is without prejudice to any position it may take vis-à-vis other notified draft measures.

The Commission points out that, in accordance with Article 7a of the Framework Directive, the draft measures on the market for call termination on individual public telephone networks provided at a fixed location in Latvia shall not be adopted for a further three months.

Pursuant to Article 7(7) of the Framework Directive, SPRK shall take the utmost account of the comments of other NRAs, BEREC and the Commission and may adopt the resulting draft measures concerning the markets for mobile call termination; where it does so, shall communicate it to the Commission.

The Commission's position on this particular notification is without prejudice to any position it may take *vis-à-vis* other notified draft measures.

Pursuant to Recital 17 of Recommendation 2008/850/EC¹⁸, the Commission will publish this document on its website, together with a notice inviting third parties to submit observations on this serious doubts letter within ten working days. The Commission does not consider the information contained herein to be confidential. You are invited to inform the Commission¹⁹ within three working days following receipt whether you consider that, in accordance with European Union and national rules on business confidentiality, this document contains confidential information which you wish to have deleted prior to such publication. You should give reasons for such request.

¹⁸ Commission Recommendation 2008/850/EC of 15 October 2008 on notifications, time limits and consultations provided for in Article 7 of Directive 2002/21/EC, OJ L 301, 12.11.2008, p. 23.

¹⁹ Your request should be sent either by email: CNECT-ARTICLE7@ec.europa.eu or by fax: +32.2.298.87.82.

Yours sincerely,
For the Commission
Siim Kallas
Vice-President