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National Media and
Infocommunications Authority
(NMHH)

Ostrom u., 23-25
H-1015, Budapest
Hungary

For the attention of:
Ms. Annamária Szalai
President

Fax: +36 1 457 7171

Dear Ms. Szalai,

Subject: **Commission decision concerning Case HU/2011/1223: Wholesale market for call origination on the public telephone network provided at a fixed location**

Commission decision concerning Case HU/2011/1224: Wholesale market for call termination on individual public telephone networks provided at a fixed location

Comments pursuant to Article 7(3) of Directive 2002/21/EC[1]

I. PROCEDURE

On 20 May 2011, the Commission registered a notification from the Hungarian national regulatory authority, National Media and Infocommunications Authority (NMHH) concerning the third review of the markets for call origination on the public telephone network provided at a fixed location and for call termination on individual public telephone networks provided at a fixed location in Hungary[2].

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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.

2 Corresponding to markets 2 and 3 of the 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

The national consultation[3] ran from 24 February 2011 May and 16 March 2011.

On 1 June 2011 a request for information[4] was sent to NMHH and a response was received on 6 June 2011.

Pursuant to Article 7(3) of the Framework Directive, national regulatory authorities (NRAs) and the Commission may make comments on notified draft measures to the NRA concerned.

II. DESCRIPTION OF THE DRAFT MEASURES

II.1. Background

The second review of the wholesale markets in question was previously notified to and assessed by the Commission under case numbers HU/2007/0726[5] and HU/2007/0727[6], respectively.

With regard to the market for call origination NMHH identified at that time four separate relevant geographic markets, each corresponding to the respective operating areas of the incumbent local network operators (local incumbents): Magyar Telekom, Invitel, Hungarotel and Monortel. NMHH concluded that each of the four local incumbents should be designated as having significant market power (SMP) in its respective relevant market and imposed upon them the following obligations: (i) transparency, (ii) accounting separation, (iii) access and interconnection and (iv) price control and cost-accounting.

With regard to the market for call termination NMHH identified fifteen separate relevant markets at that time, each corresponding to the respective fixed access networks. NMHH designated each of the identified network operators with SMP on their respective relevant markets and imposed different sets of remedies on the following two groups of operators: (i) the first group comprising the abovementioned local incumbents and (ii) the second group consisting of all other SMP operators. NMHH imposed upon the first group the whole set of obligations provided in the Access Directive whereas it only imposed the obligations of transparency and non-discrimination on the second group.

The Commission made comments on the latter market analysis. The Commission did not consider appropriate the non-discrimination remedy that obliged operators having SMP in call termination markets to contract with a transit provider selected by the third network to hand over traffic for outgoing calls and therefore called on NMHH to impose only those regulatory obligations which were in line with the objectives of the Framework Directive and address the identified market failure in the notified relevant markets. Furthermore the Commission invited NMHH to consider imposing appropriate price control obligations on the second group comprising the alternative operators. Finally, the Commission invited NMHH to revisit its analysis as soon as the Termination Rates Recommendation was established.

Council on a common regulatory framework for electronic communications networks and services (Recommendation), OJ L 344, 28.12.2007, p. 65.

3 In accordance with Article 6 of the Framework Directive.

4 Pursuant to Article 5(2) of the Framework Directive.

5 SG-Greffe (2007) D/207483.

6 SG-Greffe (2007) D/205710.

II.2. Market definition

Wholesale market for call origination

NMHH sets out that the market for call origination includes the conveyance of local, national, international and internet calls originated by the fixed network operator's own subscriber to the point of interconnection of the network operator purchasing the service in question[7]. The market is defined in technology neutral terms as it encompasses both Public Switched Telephone Network (PSTN) and IP-technology based call origination services. The wholesale services such as local loop unbundling and bitstream are not considered to be substitutes.

As to the geographic scope of the markets, NMHH identifies three separate relevant geographic markets which correspond to the respective operating areas of the actual local incumbents: Magyar Telekom (thirty-nine numbering areas), Invitel (fourteen numbering areas) and UPC (one numbering area)[8].

Wholesale market for call termination

The wholesale call termination market is defined for each individual fixed network and comprises the termination services that each operator provides in order to carry the calls from the interconnection point to its end-users. NMHH defines the market in technology neutral terms in the same manner as with the market for call origination, i.e. IP based call termination service is part of the relevant market.

As to the geographic scope of the markets, NMHH identifies thirty seven separate relevant markets which correspond to the network of each fixed operator.

II.3. Finding of significant market power

NMHH intends to designate the local incumbents, Magyar Telekom, Invitel and UPC, as having SMP on both the above-mentioned wholesale markets.

With regard to the markets for call origination the main criteria considered by NMHH when reaching its conclusion include: (i) market share, (ii) overall size of the undertaking, (iii) ownership of an infrastructure not easily duplicable, (iv) easy or privileged access to financial resources, (v) economies of scale, (vi) economies of scope, (vii) vertical integration, (viii) absence of potential competition and (ix) absence or low countervailing buying power.

Concerning the wholesale market for call termination, NMHH intends to designate with SMP, in addition to Magyar Telekom, Invitel and UPC, the thirty-four alternative access network operators (ANOs) on the basis of the following criteria: (i) market share (each operator is in a monopoly position), (ii) absence of potential competition, (iii) ownership of an infrastructure not easily duplicable and (iv) absence or low countervailing buying power.

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7 As well as a number of ancillary services.

8 Since the second market review the number of local incumbents has reduced because Invitel and Hungarotel merged and UPC and Monortel merged, respectively. NMHH carries out the analysis of the geographic scope of the market by taking into account both structural and behavioural elements in the former concession areas and numbering areas.

II.4. Regulatory Remedies

Local incumbents (Magyar Telekom, Invitel and UPC)

NMHH proposes to impose on the local incumbents the following regulatory remedies for the provision of wholesale services for call origination and call termination:

- Transparency, according to which the incumbents are not required to prepare new Reference Offers (RO) but amend the actual ones in an appropriate manner[9].
- Price control and cost accounting obligations. Magyar Telekom's interconnection rates (i.e. fixed origination rates and fixed termination rates (FTRs))[10] are due to be set on the basis of the TD-LRIC cost model[11] while Invitel and UPC must set their rates according to the following formulas:

   i. Invitel's general call interconnection rate = Magyar Telekom's general call interconnection rate[12] + (Invitel's regulated rate for "Local call interconnection service"[13] – Magyar Telekom's general call interconnection rate) x 30%.

   ii. Invitel's regional call interconnection rate = (Magyar Telekom's regional call interconnection rate / Magyar Telekom's general call interconnection rate) x Invitel's general call interconnection rate.

   iii. Invitel's national call interconnection rate = (Magyar Telekom's national call interconnection rate / Magyar Telekom's general call interconnection rate) x Invitel general call interconnection rate.

   iv. UPC's general call interconnection rate = Magyar Telekom's general interconnection rate + (UPC's regulated interconnection rate[14] – Magyar Telekom's general call interconnection rate) x 30%.

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9 UPC is allowed to amend its predecessor's RO (Monortel) in order to comply with the transparency obligation. The amendments must, inter alia, reflect the new rates for call origination and call termination. Moreover, the local incumbents must also publish separately on their websites, information (about location, technology, etc.) relating to the interconnection points and interfaces mentioned in their reference offers.

10 For sake of simplicity the interconnection service refers to both the call origination and the call termination services and equivalently the interconnection rates to both the call origination rates and the FTRs.

11 Magyar Telekom must set cost oriented interconnection rates for the general, regional and national call interconnection services where: (i) the general call interconnection service is provided if there is no additional PSTN switching exchange between the interconnection point and the switching equipment of the calling/called subscriber or if the interconnection point and the calling/called subscriber belong to the same numbering district, (ii) the regional call interconnection service is provided if the call between the interconnection point and the switching equipment of the calling/called subscriber passes through at least one PSTN transit exchange and (iii) the national call termination service is provided if the call between the interconnection point and the switching equipment of the calling/called subscriber passes through at least two PSTN transit exchanges.

12 To be set in accordance with the cost model proposed in the current notification.

13 Set in 2009 (Decision DH-3385-5/2009).

14 Set in 2008 (Decision DH-5634-17/2008).

Furthermore interconnection rates must be the same irrespective of the technology over which the interconnection services are provided: switched circuit technology (based on traffic minutes) or IP- technology (based on data volumes)[15].

- Non discrimination[16].
- Access and interconnection obligation, ensuring that (i) the interconnection rates at higher network levels are only set by a fixed operator which offers interconnection at all the lower levels and (ii) every operator can interconnect to each local incumbent at a single interconnection point which permits them to have access to any subscriber of the local incumbent, thereby avoiding inefficient investment.[17]
- Accounting separation.

ANOs

NMHH proposes to impose the following regulatory remedies on the ANOs for the provision of wholesale services for call termination:

- Transparency, according to which they are not required to prepare a Reference Offer but to publish the service conditions and charges on their websites and also to identify the provider for the transit service[18].
- Price control and cost accounting obligations, requiring ANOs to set their FTRs according to the formula:

    i. ANO's FTR = Magyar Telekom's general FTR + (ANO's FTR on 12 November 2009 – Magyar Telekom's general FTR) x 30%.

- Access and interconnection obligation, according to which ANOs must provide the general call termination service[19].

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15 In its reply to the request for information (RFI) NMHH specifies that the local incumbents will communicate their interconnection rates, calculated on the basis of this methodology, at the same time as the RO and they will be subject to the confirmation of NMHH after a national consultation procedure. ANOs' charges, though, are not to be subject to such confirmation. As the aim of this procedure is to monitor the fulfilment of the remedies proposed in the current notification NMHH considers that its outcomes must not be notified under the Article 7(3) of the Framework Directive. NMHH, however, confirms that the BU-LRIC model, once developed, will be notified to the Commission together with the charges calculated accordingly.

16 This obligation is only proposed in the wholesale markets for call termination but not for call origination.

17 The local incumbent can remove, relocate or modify the interconnection points (due to technological changes) only if they have reported it at least three years in advance. They must also regularly publish (with a periodicity of at least six months) the network development plans regarding the setting of IP-based interconnection points.

18 NMHH explains that an interface between the traditional PSTN and the cable television networks is needed because the latter transmits telephone calls through IP packages and their head-ends are usually unsuitable for receiving and transmitting class 7 signals from the circuit switched network. NMHH points out that some small cable television operators often require an intermediate transit service provider to terminate the calls originated in the traditional PSTN network. Thus NMHH proposes to require these small ANOs to name the transit service provider which owns the interface and national point code for call termination in order to facilitate the interconnection.

19 The time requirements imposed on the local incumbents for communicating in advance (i) the removal and/or change of the interconnection points and (ii) the deployment plans of IP based interconnection points are applicable to ANOs.

- Non-discrimination

As to the price control and cost accounting obligations on the wholesale markets for termination NMHH argues that a BU-LRIC cost model could not be set up in the course of the present proceeding because of the time required for putting in place such a cost model. NMHH therefore (i) concludes that the current top-down (TD-LRIC) method based on Magyar Telekom's network has to be applied for setting FTRs and (ii) will impose the cost orientation obligation based on a BU-LRIC model (i.e. in line with the Termination Rates Recommendation) in the next market review and within the timeframe set by the Recommendation.

Furthermore NMHH states that it is necessary to shift towards price symmetry up to the implementation of the BU-LRIC model.[20] NMHH considers that, prior to the adoption of the uniform BU-LRIC rates, this temporary regulation will ensure a gradual implementation of the required FTR reduction and avoid those negative effects that an eventual abrupt price cut could have on Invitel, UPC and the ANOs.

III. COMMENTS

On the basis of the present notification and the additional information provided by NMHH, the Commission has the following comments[21]:

Need for an appropriate cost accounting obligation in the fixed termination markets

The Commission has on numerous occasions expressed the view that termination rates should be set at the cost which would be faced by an efficient operator providing the relevant service[22], and in order to determine the efficient cost level, the Commission has recommended a forward-looking long-run incremental cost (FL-LRIC) model as the relevant costing methodology. The Commission is of the view that although top-down models can avoid disincentives to invest, they do not necessarily promote efficiency to the extent bottom-up models do, since they normally allow for the recovery of the costs incurred as a result of operator's inefficiency as well. The Commission’s Termination Rates Recommendation suggests therefore a calculation evaluation of efficient costs based on the use of a bottom-up modelling approach, which could be reconciled with a top-down approach.

The Commission takes note of the fact that NMHH (i) is not applying a bottom-up LRIC cost model but a top-down LRIC (based on Magyar Telekom data) and (ii) postpones the implementation of a bottom-up LRIC model until the next review of wholesale markets for termination in two years time.

On this basis, NMHH will adopt the BU LRIC model only after 31 December

[20] In its reply to the RFI NMHH explains that it is more appropriate to carry out another market analysis prior to the adoption of the BU-LRIC cost model because of the constantly growing number of market player entering the relevant market. NMHH further considers that its decision to carry out the market analysis in two years time (according to the timeframe set in the actual regulatory framework in Hungary) allows the NRA to comply with the deadlines established in the Termination Rates Recommendation and to collect the opinions of these new operators.

[21] In accordance with Article 7(3) of the Framework Directive.

[22] Cases UK/2006/0498, FR/2007/0669, IT/2008/0802, PL/2008/0814 and BG/2009/0865.

2012 and its implementation will probably be accomplished only by 1 July 2014[23].

The Commission invites NMHH to consider fully aligning its cost accounting methodology with the recommended BU LRIC model based on the current costs of an efficient operator already by the end of 2012.

Price Asymmetries in FTRs

The Commission notes that NMHH proposes to reduce the current price asymmetry in FTRs as a first step towards symmetry based on a BU-LRIC cost model. Nonetheless, the Commission notes that not only the ANOs but also the other local incumbents are to be granted a price premium over Magyar Telekom's FTR during the next regulatory period.[24] NMHH recognises in its reply to the request for information that this approach may result in 37 different FTRs[25].

As stated in the Termination Rates Recommendation any deviation from a single efficient cost level must be justified by objective cost differences outside the control of the operators concerned. In fixed networks, no such objective cost differences outside the control of the operator have been identified. In fact, the potential transitional period of price asymmetry in favour of the new entrants (up to four years) that is foreseen by the Termination Rates Recommendation only applies to mobile termination rates (MTRs), but not FTRs[26].

The Commission considers that NMHH has not provided adequate justification for asymmetry of FTRs in Hungary, i.e. on the basis of objective cost differences. NMHH mainly intends to reach a balance between the need for price reduction and convergence in FTRs, on the one hand, and the need to mitigate its impact on the operators' business, on the other hand.

Therefore the Commission asks NMHH to take full account of the Termination Rates Recommendation and to achieve symmetrical, cost efficient FTRs as soon as possible.

Notification requirements as to the price control obligation

As NMHH reserves the right to require prices to be amended, where appropriate, the Commission reminds the Hungarian regulator that any regulatory measures imposing or amending wholesale access prices are required to be notified under Article 7(3) of the Framework Directive.

Pursuant to Article 7(5) of the Framework Directive, NMHH shall take the utmost account of comments of other NRAs and the Commission and may adopt the resulting draft measures and, where it does so, shall communicate them to the Commission.

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23 Under the assumption that the development of a BU-LRIC model would require one year since the approval of the next market review on approximately mid 2013.

24 Approximately equal to the 30% of the resulting difference between the respective current price (of Invitel, UPC and the ANOs) and forthcoming price based on Magyar Telekom's TD LRIC model.

25 According to the reply the current FTRs for the general call termination service can vary from 0.68 (0.68) HUF/min to 3.60 (2.40) HUF/min for peak (off-peak) time. In the case of the local incumbents the difference tends to be lower (from 1.39 (0.82) HUF/min to 2.04 (1.09) HUF/min).

26 Cases CY/2011/1170 and PL/2011/1173.

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 Point 15 of Recommendation 2008/850/EC[27] the Commission will publish this document on its website. The Commission does not consider the information contained herein to be confidential. You are invited to inform the Commission[28] within three working days following receipt whether you consider that, in accordance with EU and national rules on business confidentiality, this document contains confidential information which you wish to have deleted prior to such publication[29]. You should give reasons for any such request.

Yours sincerely,
For the Commission,
Robert Madelin
Director-General

[27] 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 of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, OJ L 301, 12.11.2008, p. 23.

[28] Your request should be sent either by email: INFSO-COMP-ARTICLE7@ec.europa.eu or by fax: +32 2 298 87 82.

[29] The Commission may inform the public of the result of its assessment before the end of this three-day period.