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Sabiedrisko Pakalpojumu
Regulēšanas Komisija (SPRK)

Brīvības iela 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/2012/1355: 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

I. PROCEDURE

On 13 July 2012, 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 in Latvia.

The national consultation³ started on 8 May 2012 and lasted 30 days.

On 23 July 2012, a request for information (RFI)⁴ was sent to SPRK and a response was

¹ Under Article 7 of 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.

³ In accordance with Article 6 of the Framework Directive.

received on 26 July 2012.

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

The third review of markets for fixed call termination in Latvia was previously notified to and assessed by the Commission under case LV/2011/1199⁵.

SPRK proposed to designate 41 operators, including the incumbent SIA Lattelecom, with SMP on their respective fixed public telephone networks.

As regards the remedies SPRK confirmed all the obligations for SIA Lattelecom, while it imposed on alternative network operators (ANOs) only a transparency obligation and a price control obligation. SPRK confirmed the fixed termination rates set in the decision of 2010 notified to and assessed by the Commission under the case LV/2010/1029⁶. The rates were set according to a decision of 30 November 2005, using a top-down fully distributed costs model.

The Commission reiterated its previous comments regarding the need for an appropriate price control using a cost methodology in line with the Termination Rates Recommendation⁷. Moreover, the Commission invited SPRK to impose an effective access obligation also on ANOs.

II.2. The notified draft measure

In the present notification SPRK proposes to set a new level of fixed termination rates (FTRs). The price regulation proposed follows the application of a top-down fully distributed cost model, which was applied previously⁸.

SPRK notes that the current call termination tariff ceiling⁹ in the fixed market considerably exceeds the call termination service provision costs of SIA Lattelecom in 2010¹⁰. Moreover, SPRK considers SIA Lattelecom's cost evolution over the last three years and further prospective cost decreases if the services are provided in most effective

⁴ In accordance with Article 5(2) of the Framework Directive.

⁵ SG-Greffe(2011)D/5941.

⁶ SG-Greffe(2010)D/1280.

⁷ Commission Recommendation 2009/396/EC on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (Termination Rates Recommendation), OJL124, 20.5.2009, p. 67.

⁸ As described in section II.1.

⁹ The current FTRs are 0.0054 LVL (~ 0.78 ¢cent) per call and 0.005 LVL (~ 0.72 ¢cent) per minute. SPRK specified in the answer to the RFI that no common cost are directly included in the calculation of FTRs. The current tariffs were adopted in 2010 (Case LV/2010/1029) and confirmed in 2011 (Case LV/2011/1199).

¹⁰ The tariff ceiling is approximately 47 % higher than the costs of SIA Lattelecom in 2010.

way. Hence, SPRK proposes to reduce SIA Lattelcom's current FTRs by 64%. Following this reduction SPRK proposes to set new FTRs as from the 1 April 2013¹¹ until 2014¹² at the level of 0.002 LVL (~0.29 €cent) per call and 0.0018 LVL (~0.26 €cent) per minute.¹³

SPRK explains that due to tight budgetary constraints they are not in the position to develop the recommended BU-LRIC model¹⁴. In the answer to the RFI, SPRK also generally refers to constantly decreasing revenues in the electronic communications market as well as both small size of the market and market participants.

As regard the use of alternative methodologies (i.e. benchmarking) resulting in outcomes consistent with the Termination Rates Recommendation, SPRK underlines that this is not feasible at the moment. SPRK specifies that information available on the costs of an efficient operator providing fixed call termination services is insufficient to serve as the basis for benchmarking¹⁵.

However, SPRK states that it will regularly compare the FTRs in Latvia with the termination tariffs in the European Union and in case the FTRs in Latvia differ considerably from the average call termination tariffs set by other regulatory authorities using the recommended cost methodology, SPRK will review the tariffs proposed in the present notification.

III. ASSESSMENT

SPRK's draft measure concerning the markets for call termination on individual public telephone networks provided at a fixed location falls within Article 7a(1) of the Framework Directive and would affect trade between Member States.

The Commission considers that the notified draft measure falls under the Commission's powers of ensuring consistent application of remedies as set out in Article 7a of the Framework Directive, as the notified measure aims at imposing an obligation on an operator in conjunction with Articles 9 to 13 of the Access Directive¹⁶.

¹¹ In the answer to the RFI SPRK specifies that there is a usual procedure to give six month notice before the implementation of important decisions. A deviation from this practice could also be challenged in the Court with favourable results. They intend to adopt the final decision at the beginning of September.

¹² The Commission understands that in 2013 the SPRK intends to review the FTR cap applicable from 1 July 2014.

¹³ The tariffs will remain valid until new circumstances (i.e. data for benchmarking) or new cost information will be available and justify the adoption of a new decision.

¹⁴ Moreover, SPRK underlines that considering the size of the market at national level, the size of market players and the fact that revenues in the electronic communication market are constantly decreasing, the implementation of the model would be disproportionate.

¹⁵ SPRK however considers that the proposed tariffs are in line with the EU average as resulting from the BEREC report of 24 May 2012. The average as published by BEREC is at the first layer on the 1 January 2012 0.0036 LVL (~ 0.54 €cent).

¹⁶ 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 (Access Directive), OJ L 337, 18.12.2009, p. 37.

The draft measure 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. They comprise measures that have a significant impact on operators or users in other Member States. Consequently, such draft measures may affect the pattern of trade between Member States¹⁷.

The regulatory approach taken by the SPRK in its notification imposes price regulation on traffic terminated on fixed networks which is based on a top-down fully distributed cost model, which fails to ensure that rates are set on the basis of the costs of an efficient operator.

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

The Commission expresses serious doubts in this regard for the following principal reasons:

The need to ensure that customers derive maximum benefits in terms of efficient cost-based termination rates

Compliance with Article 8(4) and 13(2) of the Access Directive in conjunction with Article 8 and Article 16(4) of the Framework Directive

The Commission refers to Article 8(4) and 13(2) of the Access Directive which requires NRAs (i) to impose remedies which are based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of the Framework Directive and (ii) in relation to the imposition of price controls to ensure that the cost recovery mechanism serves to promote efficiency and sustainable competition and maximises consumer benefit. Moreover, the Commission refers to Article 16(4) of the Framework Directive, which requires NRAs to impose on SMP undertakings appropriate regulatory obligations.

In addition, the Commission would like to underline that pursuant to Article 8(3) of the Framework Directive, NRAs shall contribute to the development of the internal market by cooperating with each other, with the Commission and BEREC in a transparent manner in order to ensure not only the development of a consistent regulatory practice but also consistent application of the Framework Directive and the Specific Directives (together, the Regulatory Framework).

In this regard, the Commission would like to point out that it may issue recommendations¹⁸ on the harmonised application of the Regulatory Framework in order to further the achievement of the objectives set out in Article 8 of the Framework Directive. This right arises in particular where the Commission finds

¹⁷ See Recital 38 of the Framework Directive.

¹⁸ In accordance with Article 19 of the Framework Directive.

that divergences in the implementation by the NRAs of their regulatory tasks under the Regulatory Framework may create a barrier to the internal market. It is in this context that the Commission, in order to ensure a correct and coherent interpretation and application of the relevant provisions of the Regulatory Framework within the EU, adopted the Termination Rates Recommendation, setting out a consistent approach that the NRAs should in principle follow regarding price control obligations for fixed and mobile termination rates.

For this purpose, the Commission recommended that NRAs should ensure that termination rates are implemented at a cost efficient, symmetric level as of 31 December 2012¹⁹. Moreover, it recommended that the level should be determined including only those costs which would be avoided if a wholesale voice call termination services were no longer provided to third parties²⁰. According to Recital 22 and of Recommend 12 of the Termination Rates Recommendation, in exceptional circumstances, where an NRA is not in a position, due to limited resources, to finalise a pure BU-LRIC model in a timely manner, it could set interim prices based on an alternative approach until 1 July 2014.

Indeed, Recital 20 and Article 13(2) of the Access Directive note that the method of cost recovery should be appropriate in the particular circumstances, taking account of the need to promote efficiency and sustainable competition and maximise consumer benefit. As also clarified in the Termination Rates Recommendation, the Commission considers that, given the characteristics of the wholesale mobile and fixed termination market, and the associated competitive and distributional concerns, the cost orientation remedy based on the pure BU-LRIC methodology and symmetrical termination rates would promote competition, by among other things, ensuring that that all users derive maximum benefit in terms of choice, price and quality, in line with Article 8(2) of the Framework Directive, and hence could be considered the most appropriate remedy.

Moreover, the Commission observes that fixed termination rates set at an efficient level contribute to a level playing field among operators, by eliminating competitive distortions between fixed and mobile networks in the provision of mobile-to-fixed and fixed calls, respectively, and between operators with asymmetric market shares in the provision of their on/off-net offers.

While the Commission recognises that the NRAs have a margin of discretion to propose any alternative methodology to regulate termination rates, it would like to underline that any alternative methodology has to be duly justified, in order to show that it fully complies with the policy objectives and regulatory principles of the Regulatory Framework. In particular, such alternative methodology would have to take into account the characteristics of the specific markets to be regulated and be appropriate in light of the policy objectives and regulatory principles enshrined in Article 8 of the Framework Directive, in particular the objectives of promoting competition and ensuring that that all users derive maximum benefit in terms of choice, price and quality in line with Article 8(2).

¹⁹ Recommend 11 of the Recommendation.

²⁰ Recommend 6 of the Recommendation.

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 top-down fully distributed cost model and not the recommended pure BU-LRIC model. Even though SPRK proposes a significant decrease of the fixed termination rates when compared to the current rates, such proposed decrease simply aligns FTRs with the results of the chosen cost model. It is not set on the basis of the costs of an efficient operator. The Commission notes that in a competitive environment, operators would compete on the basis of current costs and would not be compensated for costs which have been incurred through inefficiencies.

In this respect, the Commission points out that the top-down fully distributed cost methodology proposed by SPRK to set 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, as required by Article 13(2) of the Access Directive, which requires NRAs to ensure that any cost recovery mechanism or pricing methodology that is mandated serves to promote efficiency and sustainable competition and maximise consumer benefits while NRAs may also take account of prices available in comparable competitive markets, and would 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 by SPRK would equally allow promoting efficiency and sustainable competition and maximise consumer benefits in line with the Regulatory Framework. Indeed, the justifications put forward by SPRK are rather general statements and are not supported by any qualitative or quantitative assessment based on the national circumstances.

First of all, the Commission notes that the FTRs to be applied until the notified draft measure is to be implemented, i.e. until 1 April 2013, amount to 0.0054 LVL (-0.78 ¢cent) per call and 0.005 LVL (-0.72 ¢cent) per minute. In SPRK's own admission these rates exceed considerably (by 47%) SIA Lattelecom's cost of providing call termination services, whilst the Termination Rates Recommendation foresees cost-efficient rates already as of 1 January 2013.

Secondly, the Commission notes that the FTRs to be applied as of 1 April 2013 (presumably until 1 July 2014), are at the level of 0.002 LVL (~0.29 ¢cent) per call and 0.0018 LVL (~0.26 ¢cent) per minute. These rates are clearly exceeding the rates set by those countries, which have already implemented a pure BU-LRIC fixed termination model (France²¹), or calculated pure BU-LRIC rates (Netherlands²²) for the respective time-period.

²¹ The FTRs set by France (decision of 26 July 2011 (2011-0926)) amount to 0.08 ¢cent/minute.

²² The Pure BU-LRIC FTRs as calculated by OPTA in its July 2010 decision amount to 0.36 ¢cents. OPTA's decision was later overturned in court but the accuracy of the model itself was not put into question.

On the basis of the above, the Commission notes that where SPRK leaves FTRs at their current level (until 1 April 2013), and where SPRK sets FTRs according to the fully distributed cost model (as of April 2013), 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. SPRK's explanation that the development of an appropriate model at a national level would be disproportionate is, in Commission's view, not an adequate justification to simply continue with the current practice which demonstrably results in rates which are above the efficient level.

The Commission therefore considers, at this stage, that the result of the Latvian model is not consistent with those of competitive markets, exceeding the average of the termination rates set by NRAs implementing²³ the most efficient cost methodology, by a very 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

The Commission would like to further note that if the termination rates are set by one NRA above the efficient level, the terminating operators in that Member State will be able, on the basis of the calling party pays principle, to benefit from this rate at the expense of the operators, and ultimately the consumers, in the Member State from which the call originates. Hence, the considerable difference in absolute terms derived from rates based on methodologies which would not ensure a cost-efficient level would be incurred at the expense of the operators, and eventually consumers, in the Member States from where the fixed/mobile calls originate.

Moreover, the Commission observes that FTRs set at an efficient level contribute to a level playing field not only at national but also at EU level, by eliminating competitive distortions between fixed and mobile networks.

Therefore, the Commission considers, at this stage, that the draft measure would create barriers to the internal market.

²³ Termination rates set by NRAs implementing the most efficient methodology correspond to the pure BU-LRIC rates set by the NRAs by way of final decisions in the respective Member States. See case EL/2012/1343.

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 measure regarding the remedies on the markets for fixed call termination in Latvia shall not be adopted for a further three months.

Pursuant to Recital 17 of Recommendation 2008/850/EC²⁴, 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 Commission²⁵ 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.

Yours sincerely,
For the Commission,
Máire GEOGHEGAN-QUINN
Member of the Commission

²⁴ 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.

²⁵ Your request should be sent either by email: INFSO-COMP-ARTICLE7@ec.europa.eu or by fax: +32.2.298.87.82.