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Czech Telecommunication Office
headquartered at Sokolovská 219, Prague 9
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[Stamp and Signature:



THIS DECISION BECAME FINAL
on [handwritten] 31. 5. 2006
Czech Telecommunication Office
Economic Regulation Department
Date [signature: Smrkovská]

Prague, 18 May 2006
Ref.: 15 856/2006-611/V.vyř.

In proceedings initiated *ex officio* with ETEL, s.r.o., with registered office at Benediktská 2/685, 110 00, Prague 1, Reg. Number 25630636 on 21 March 2006 in the matter of the imposition of obligation related to price regulation on an undertaking with significant market power, the Council of the Czech Telecommunication Office as the appropriate state administration body under Section 107(8)(b)(5) of Act No. 127/2005 on Electronic Communications and on Amendment to Certain Related Acts (Electronic Communications Act), as amended (the "Act") and under Section 10 of Act No. 500/2004, Rules of Administrative Procedure, as amended, hereby issues this

Decision on Price No. CEN/9/05.2006-47:

I.

(1) Under Section 51(3)(g) and Section 59 of the Act and in accordance with the results of the analysis of the relevant market of "Call Termination in Individual Public Telephone Networks at a Fixed Location", issued in Czech Telecommunication Office's Measure of General Nature No. A/9/04.2006-19, the obligation to negotiate charges for interconnection in its public telephone network for the call termination service (hereinafter referred to as "termination prices") is hereby imposed on ETEL, s.r.o., with registered office at Benediktská 2/685, 110 00, Prague 1, Reg. Number 25630636 (hereinafter referred to as the "Party to the Proceedings") so as to avoid exceeding the maximum prices specified below:

Termination with interconnection at:	Traffic time	Maximum termination price [CZK/min] excl. of VAT
a) local switch (HOST)	peak	0.30
	off peak	0.15
b) last transit switch	peak	0.38
	off peak	0.19

- a) termination with interconnection at local switch means a case where the end point in the interconnected publicly accessible telephone network to which the call is routed is located in the access area of the gateway switch in which the networks are interconnected, the gateway switch being the local switch;
- b) termination with interconnection at the last transit switch means a case where the end point in the interconnected publicly accessible telephone network to which the call is routed is located in the access area of the gateway switch in which the networks are interconnected, the gateway switch being the transit switch.

The peak time is the period from 7:00 to 19:00 hours on workdays. The off peak time is the period from 19:00 to 7:00 hours of the following day on workdays and the entire 24 hour period on Saturdays, Sundays and on holidays recognised by the Government.

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(2) Regulation based on maximum prices as referred to in Paragraph 1 above applies to calls to the end point of the public telephone network of the Party to the Proceedings, to which the terminal equipment of the called subscriber is connected, which calls are incoming calls from another public electronic communication network.

II.

(1) For newly concluded agreements, the Party to the Proceedings shall negotiate prices in compliance with the price regulation based on Part I of the Decision award and shall start doing so from the effective date of the Decision.

(2) In the remaining cases the Party to the Proceedings shall negotiate prices in compliance with the price regulation based on Part I of the Decision award and shall start doing so within two months of the effective date of the Decision.

Substantiation

In accordance with Section 51(1) and (2) of the Act, the Czech Telecommunication Office (“the Office”) carried out an analysis of Market No. 9 - Call Termination in Individual Public Telephone Networks at a Fixed Location (“Market No. 9”), which it made public on the official board on 16 March 2006 under Ref. No. 1 514/2006-609/III vyř. and, upon notification to the European Commission, it issued it as Measure of General Nature No. A/9/04.2006-19 of 19 April 2006. The results of the analysis showed that Market No. 9 is not an effectively competitive market because there are undertakings with significant market power doing business on it. The analysis also showed that prices disproportionately high and unfair to the end users are used on the market in cases where no price regulation is applied. It follows from the nature of Market No. 9 that each service provider is an undertaking with significant market power because each of them has a 100% share of its network. For this reason, the administrative body proposed to apply price-control obligations, which it intends to impose in accordance with Section 51(3) of the Act.

By the administrative body’s Decision No. SMP/9/05.2006-36 of 15 May 2006, which was issued under Ref. No. 11 486/2006-609/ IV. vyř. and became final on 16 May 2006, the Party to the Proceedings was determined to be an undertaking with significant market power.

On Part I of the Decision award

On the basis of the result of the analysis, Measure of General Nature No. A/9/04.2006-19 was issued in accordance with Section 51(2) of the Act, proposing to impose the obligation to enable access to specific network elements and associated facilities under Section 84 of the Act, obligation to ensure non-discrimination under Section 81 of the Act, obligation to maintain separate records of costs and revenues under Section 86 of the Act, and price regulation-related obligations under Sections 56 and 57 of the Act.

With respect to this proposal, the administrative body considered the proposed obligations. The obligation specified in Part I of the Decision award was imposed on the Party to the Proceedings through this Decision with reference to what is stated below. The imposition of obligations under Sections 51(3)(a) to (f) is the subject of separate administrative proceedings.

The applied method of price regulation using maximum prices for termination based on Section 58(1)(a) of the Act was chosen, because determination of a price using the LRIC model applied to the termination services requires large amounts of data to fill the model. Their specific levels must be verified in detail by the administrative body in order to ensure that they are used correctly. In such a situation the determination of the maximum price appears to be the only possible solution.

To determine the maximum prices for interconnection for the call termination service, the Office used the costing model (LRIC), based on the principle of long-term incremental costs. The LRIC method was chosen in order to identify an efficient operator’s costs.

To fill the LRIC model with data, when determining the maximum price on the market, the Office used as a basis the topology of the network of ČESKÝ TELECOM, a.s. as the largest provider

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(largest in terms of the public telephone network subscriber lines). The application of this method to other operators relied on the generally accepted principle by which the remaining operators' networks were built in a competitive environment and their efficiency is therefore at least as high as that of ČESKÝ TELECOM, a.s.

The determined prices reflect the effectively and efficiently spent funds, the specific risks and the recovery of investments within a reasonable period of time in compliance with Section 57(3) of the Act. The return on capital investment before tax (weighted average cost of capital WACC) was set at 11.18%, which is the amount set out in Regulation [Measure] of General Nature No. OOP/4/03.2006-3. The determination of the WACC is in keeping with general practice in the electronic communications sector. Its value was determined as the arithmetic mean for the values used in the studies by Raiffeisenbank a.s. and CENTRAL EUROPEAN CAPITAL CZ, s.r.o. Both these studies were prepared for the Czech Telecommunication Office in 2005. The mean also comprised the WACC values determined for ČESKÝ TELECOM, a.s. by another four independent qualified entities, including Deutsche Bank, Patria Finance a.s., WOOD & Company Financial Services, a.s., and Morgan Stanley.

Part I of the awarded Decision defines the maximum termination prices. The prices are differentiated by the location of the access gateway switch and the end point of the interconnected publicly accessible telephone network and also by the peak and off peak time. For the purposes of this Decision on Price, there are definitions of the termination prices in the first paragraph of the Decision award. In the second paragraph of that part of the Decision the administrative body defined the calls regulated by the price cap (the maximum prices determined in the first paragraph).

In the event that interconnection for termination takes place in a switch other than the local or last transit switch, the prices should be negotiated so that the resultant price is a sum of the agreed termination price (respecting the proposed Decision on Price) and the price for the corresponding transit.

On Part II of the Decision award

For the contracts to be newly concluded, the Party to the Proceedings must negotiate prices in compliance with price regulation from the effective date of the Decision. In the remaining cases the Party to the Proceedings must negotiate the prices in compliance with price regulation within two months after the effective date of the Decision.

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With respect to the above, administrative procedure under Section 51(3)(g) of the Act was instituted against the Party to the Proceedings on 20 March 2006 in respect of the imposition of obligations related to price regulation on undertakings with significant market power. As set out in Section 51 of the Act, the undertaking whose rights and obligations are to be decided on should be the Party to the Proceedings. Notification of the commencement of the administrative proceedings was sent to the Party to the Proceedings and it contained an invitation for the Party to the Proceedings to express its view and propose relevant evidence. For this, the Party to the Proceedings was granted a period of 7 days after the date of delivery of the notification.

The Party to the Proceedings did not submit any comments within the specified period. In the notification, the Party to the Proceedings had been advised that the Office would not take into account any comments or proposals delivered after the expiry of the period, with the exception of the comments and proposals concerning the facts to which the Party to the Proceedings could not (without its fault or negligence) respond within the period. Nevertheless, the administrative body received a submission from the Party to the Proceedings on 20 April 2006, i.e. 30 days after the commencement of the administrative proceedings. The submission contained a request for extension of the period to 30 days from the notification of the commencement of the administrative proceedings. The administrative body rejected the request for the extension of the period by its resolution of 25 April 2006.

In its submission, the Party to the Proceedings:

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- disagrees with the finding in which the Party to the Proceedings was designated as an undertaking with significant market power in relevant market No. 9 and, consequently, disagrees with the imposition of the aforementioned obligations;
- states that the mission of the Act is to support continued deregulation of the market and impose obligations on those entities that possess significant market power on the relevant market;
- requests that the analysis of market No. 9 should be performed again in compliance with the mission of the Act.

The administrative body refers to what is stated in the conclusions from the analysis of market No. 9, issued as Measure of General Nature No. A/9/04.2006-19 of 19 April 2006: each of the providers operating on relevant market No. 9 is an undertaking with significant market power, because a call can only be terminated by the provider that has the called party's number in its network. The determination of the Party to the Proceedings as an undertaking with significant market power complies with the aforementioned conclusions. To what is indicated above, the administrative body adds that the European Commission stated in its opinion of 12 April 2006 that the definition of the market complies with the Recommendation. The Commission had evaluated the notification and informed the administrative body that it had no comments on the analysis. Therefore, in accordance with Article 7 Paragraph 5 of the Framework Directive, the Office may adopt a final draft Measure.

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With respect to the above, the administrative body drew up a draft decision in that matter.

Under Section 130 of the Act and in accordance with the Czech Telecommunication Office's rules for maintaining consultations, the administrative body published on 7 April 2006 its draft Decision at the discussion site, including invitation to submit comments at the site.

The administrative body received comments from two entities. Their comments were primarily related to methodological issues, including in particular the method of determination of the maximum termination prices and prices for call transmissions between two transit switches in the case of the call termination service. The administrative body adjusted the proposed decision to reflect the outcomes of the public consultation.

All the comments and the manner they were addressed were made public in the comment settlement table at the discussion site on 3 May 2006.

The Party to the Proceedings was given an opportunity to express its view in accordance with Section 122(5) of the Act. The Party to the Proceedings familiarised with the file on 4 May 2006 and requested a 7-day period for preparing its opinion. On 11 May 2006 the administrative body received a letter from the Party to the Proceedings, where the said Party agreed with the application of the incremental cost principles (the LRIC model) to the determination of maximum prices.

The Party to the Proceedings argued that the model was not fully available and that the data used in the model were not accessible.

The LRIC incremental cost model, used for the determination of the maximum termination prices, as well as Measure of General Nature No. OOP/4/03.2006-3, were published as "Cost Model for the Service of Call Origination and Call Termination in the Public Telephone Networks at a Fixed Location" at the web site of the Office under Ref. No. 13 057/2006-611. ČESKÝ TELECOM, a.s. classified the input data as trade secret and the Office respected that. The published model is fully functional and contains all algorithms for the calculation.

The Party to the Proceedings further argued that it is inadmissible to give preferential treatment to one operator by tolerating less efficient operation of its network and thus to spread the poor efficiency throughout the termination market, and that the model should only include the costs that correspond to the principle and criterion of efficiently incurred costs. Determination of costs for the LRIC model from ČESKÝ TELECOM's data without taking into account the data from other operators leads to distortion of the competitive environment.

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The administrative authority verified and modified the LRIC model inputs proposed by ČESKÝ TELECOM, a.s. The LRIC model is based on the scorched node assumption. This principle maintains the topology of the network of ČESKÝ TELECOM, a.s.; however, the effectiveness and efficiency of the model is enhanced by interconnection of these nodes and the dimensioning of the individual switches. Enhancement of the efficiency of the costs incurred by the operator in the network is in fact the main reason why the LRIC model uses incremental costs. Modifying the input data, the administrative body saw to it that such costs actually were the costs effectively and efficiently incurred in compliance with the Act. The model itself is designed for the incumbent's nation-wide network, which involves three node levels: concentrators (RCUs), local switches (LSs) and tandem switches (TSs). From this it follows that alternative operators would in fact be unable to provide appropriate inputs, because they do not have such an extensive PSTN network. The termination prices were proposed by the administrative body as the maximum prices, rather than fixed prices. Each of the operators may within its contractual relationships negotiate lower prices, better reflecting its actual costs.

The Party to the Proceedings also requested to regulate the prices for transit to third operators' networks and the prices of line leasing for interconnection purposes.

Line leasing services and the third operator network transit services do not belong in market No. 9. Hence, no decision concerning these services and the underlying conditions may be made in these administrative proceedings, nor is it possible in this Decision to impose price-regulation obligations.

The Party to the Proceedings requested to specify the technical conditions of interconnection.

In accordance with Section 82(1) of the Act and Measure of General Nature No. OOP/7/07.2005.12, technical conditions of interconnection are part of the reference bid published by the undertaking with significant market power in that market, on which undertaking the administrative body imposed this obligation.

The Party to the Proceedings argued that the prices required by ČESKÝ TELECOM, a.s. were inadequately high, compared to the prices charged for the same services by operators in other EU countries. The Party to the Proceedings requested to reduce the prices – to review them and compare them with those used in other EU countries.

The prices appearing in the Decision are not the prices required by ČESKÝ TELECOM, a.s. In the public consultation on this draft Decision, ČESKÝ TELECOM, a.s. indicated that it disagreed with the level of the prices because, in its opinion, they did not correspond to the underlying costs (they required higher termination prices). The actual maximum prices for ČESKÝ TELECOM, a.s. were determined in other administrative proceedings.

The administrative body decided as indicated in the Decision award. It did so, with respect to the above, in compliance with the key principles based on the legal framework of the European Communities, seeking to substitute for the absent action of economic competition, to create conditions for appropriate functioning of economic competition and to protect users and other market players until a fully competitive environment is created.

Advice on Remedies:

No remedy is allowed against this Decision.

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Czech Telecommunication
Office
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[signature] Pavel Dvořák
PhDr. Pavel Dvořák, CSc.
Chairman of the Council of the
Czech Telecommunication Office