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Czech Telecommunication Office
headquartered at Sokolovská 219, Prague 9
P.O. Box 02, 225 02 Prague 025

[Stamp and Signature:



THIS DECISION BECAME FINAL

on [handwritten] 20. 12. 2006

Czech Telecommunication Office

Economic Regulation Department

Date [handwritten] 20. 12. 2006 [signature: Mičíková]

Prague, 21 November 2006
Ref.: 40 346/2006-611/IV.vyř.

In proceedings initiated *ex officio* with Telefónica O2 Czech Republic, a.s. with registered office at Olšanská 55/5, 130 34 Prague 3, Reg. Number 60193336, on 21 July 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/13/11.2006-73:

I.

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 "Wholesale Provision of Leased Line Terminating Segments in Electronic Communication Networks", issued in Czech Telecommunication Office's Regulation of General Application No. A/13/08.2006-30, price regulation is hereby imposed on Telefónica O2 Czech Republic, a.s. with registered office at Olšanská 55/5, 130 34 Prague 3, Reg. Number 60193336 (hereinafter referred to as the "Party to the Proceedings"), on the basis of setting up a mandatory pricing procedure under Section 58(1)(b)(3) as follows:

(1) The Party to Proceedings must negotiate the prices for wholesale provision of the terminating segments of leased lines at transmission rates up to 2048 kbit/s so that the prices are cost-oriented, comprising the effectively and efficiently spent costs and reasonable profit, ensuring a return on investments within a reasonable period of time, and reflecting the associated risks. In exercising this obligation, the Party to Proceedings should proceed in accordance with the Regulation of General Application issued to implement Section 86(3) of the Act, in which the methodology of service costing and revenue settlement and of cost and revenue allocation is laid down and the structure of the information to be disclosed is determined.

(2) The Party to Proceedings may negotiate prices that are lower than those determined as specified in the preceding Paragraph (1), provided that the non-discrimination principle and cross financing ban are respected.

(3) The Party to Proceedings shall negotiate prices for the different types of leased line terminating segments, the price being structured into a one-off payment for installing the leased line terminating segments plus the monthly rate for the lease of the terminating segments of the leased lines, detailed according to transmission rates (line capacity).

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II.

(1) The Party to Proceedings must publish the prices in accordance with Part I of the Decision Ruling within 120 days after the date of entry into force of the Decision.

(2) For new contracts, the Party to Proceedings must negotiate the prices in accordance with Part I of the Decision Ruling, starting from the date of making the prices public.

(3) For existing contracts, the Party to Proceedings must negotiate prices in compliance with Part I of the Decision Ruling within 60 days after the date of making the prices public.

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. 13 – Wholesale Provision of Leased Line Terminating Segments in Electronic Communication Networks (“Market No. 13”), which it made public on the official board on 13 July 2006 under Ref. No. 33 181/2006-609-609/II. vyř. and, upon notification to the European Commission, it issued it as Regulation of General Application No. A/13/08.2006-30 of 14 August 2006. The results of the analysis showed that Market No. 13 is not an effectively competitive market because there is an undertaking 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. For this reason, the administrative authority proposed to apply price-control obligations, which it intends to impose in accordance with Section 51(3)(g) of the Act.

By the administrative authority’s Decision No. SMP/13/09.2006-63 of 11 September 2006, which was issued under Ref. No. 36 522/2006-609/ V. vyř. and became final on 12 September 2006, the Party to the Proceedings was determined to be an undertaking with significant market power.

On Part I of the Ruling

On the basis of the result of the analysis, Regulation of General Application No. A/13/08.2006-30 was issued in accordance with Section 51(2) of the Act, proposing to impose the obligation to ensure non-discrimination under Section 81 of the Act, obligation to ensure transparency under Section 82 of the Act, obligation to ensure access to specific network elements and associated facilities under Section 84 of the Act, obligation to ensure separation 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 authority considered the proposed obligations. The obligation specified in Part I of the Decision Ruling 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.

In Part I of the Decision Ruling, the obligation of cost orientation of the prices for the leased line service and the mandatory procedure of price formation or calculation are imposed on the Party to Proceedings in accordance with Section 58(1)(b) of the Act. Upon analysing relevant market No. 13 and on the basis of the result obtained, the administrative authority decided to apply a milder form of price regulation to the undertaking with significant market power. This regulation consists in pricing rectification by defining two conditions: cost orientation of the prices and the mandatory pricing procedure.

The Party to Proceedings should negotiate prices so that the cost-oriented prices cover the costs expended in an effective and efficient manner plus a reasonable profit, reflect the related risks and ensure recovery of the investment within a reasonable period of time. In determining the price, the Party to Proceedings should proceed in accordance with the Regulation of General Application issued to implement Section 86(3) of the Act, laying down the method of service costing and cost and revenue allocation and defining the structure of the information to be reported.

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The Party to Proceedings is allowed also to offer prices lower than the cost-oriented prices to the detriment of profit, provided, however, that at least the costs expended in an effective and efficient manner are covered and any cross financing is avoided. By offering its prices, the Party to Proceedings must not breach the non-discrimination principle. If the Party to Proceedings negotiates lower prices it must do so under the same conditions for all contractual partners, depending, for example, on the 'quantity used'.

On Part II of the Ruling

Determining the effective date, the administrative authority considered the time needed by the Party to Proceedings to determine the prices of the leased line services so that the prices comply with the condition defined in Part I of the Ruling. The Party to Proceedings, maintaining separate accounts for costs, revenues and capital invested, should determine the prices in accordance with Part I of the Ruling and should make them public in its reference offer within 90 days of the finality of the Decision. For new contracts, the Party to Proceedings must negotiate the prices in accordance with this Decision starting from the date of making the prices public. In the remaining cases it must negotiate prices in compliance with this Decision within 60 days after the date of making the prices public.

With respect to the above, administrative proceedings under Section 51(3)(g) of the Act was instituted against the Party to Proceedings on 21 July 2006 in respect of the imposition of obligation related to price regulation on undertaking 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 only be the Party to Proceedings. Notification of the commencement of the administrative proceedings was sent to the Party to Proceedings and it contained an invitation for the Party to Proceedings to express its views and propose evidence, for which it was granted a period of 14 days after the date of delivery of the notification.

On 4 August 2006 the administrative authority received the statement of the Party to Proceedings in respect of the commenced administrative proceedings. The comments indicated below were contained in the statement submitted by the Party to Proceedings.

The Party to Proceedings believes that there were procedural faults in the act of the instituting the administrative proceedings. In the notification of the commencement of administrative proceedings ("the Notice") the administrative authority referred to the results of the analysis of market No. 13, made public on 13 July 2006 under Ref. No. 33 181/2006-609/II.vyř. on the electronic notice board of the Czech Telecommunication Office. Results of the analysis, if published in any form other than as Regulation of General Application ("OOP"), required by Section 51(1) second clause of the Act, cannot serve as a basis for the imposition of any obligations on an undertaking that has a significant market power on the relevant market. In addition, as the Party to Proceedings believes, making the results public on the electronic official notice board on 23 February 2006 cannot be considered as publishing in accordance with Section 51(2) of the Act, because the consultation process under Section 131 of the Act had not been completed. The Party to Proceedings added that, within the meaning of Section 125(2)(c) of the Act, publication in Telekomunikační Věstník (Telecommunications Bulletin) is the appropriate form of publishing the results of the analyses (in accordance with Section 51).

Referring to the objection raised by the Party to Proceedings, the administrative authority states that it commenced the administrative proceedings after carrying out an analysis of market No. 13 under Section 51(1) of the Act and that after completion of the public consultation under Section 130 of the Act, it published on its official electronic notice board, in accordance with Section 51(2) of the Act, the result of the analysis of market No. 13, including comments from the public consultation that were incorporated into it and also including the opinion of the Office for the Protection of Economic Competition. The administrative authority did so under ref. No. 33 181/2006-609/II. vyř. To meet the timescales required by the Act for the completion of the analyses of relevant markets, the Office commenced the administrative proceedings on 21 July 2006. The administrative authority granted the Party to Proceedings a reasonable period to

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express its opinion. The process of analysing market No. 13 was completed by publishing the results of the analysis and, subsequently, the analysis was sent to the European Commission for notification. The administrative authority therefore states that the launching of the administrative proceedings after making the result of the analysis public, though before the finality of Regulation of General Application No.A/13/08.2006-30, was not in contradiction with the Act and that the rights of the Party to Proceedings were not at all violated, because the Party to Proceedings had been given every opportunity to assert its rights under the legal regulations in force. Should any change be made to the results of the analysis on the basis of the notification process, the Party to Proceedings would have to be given an additional period of time for expressing its opinion. However, this did not happen and the text of the results of the analysis is identical with that of the Regulation of General Application in force.

The Party to Proceedings did not agree with the formulation of the fourth paragraph in Part I of the Decision Ruling: "The Party to Proceedings shall negotiate prices for the different types of lines, the price being structured into a one-off payment for installing the line and the monthly rate for the lease of the line. For purposes of this Decision, the type of line shall be understood to mean a line of a given length and capacity". The Party to Proceedings did not agree with the proposed criterion of line "length" and requested it to be removed. Such a criterion had not so far been used as a criterion for determining wholesale lease prices and information on line lengths is not normally available. Additional monitoring of this parameter would need too much administrative effort. Such monitoring is in practice impossible and such a criterion cannot, in principle, be introduced. In addition, the service defined as market No. 13 is a new service, because, on the wholesale level, lines have so far only been leased as a whole, i.e. including the trunk segment. The average length of the terminating segments of leased lines is between 3.5 and 4 kilometres. The Party to proceeding believed that the Czech Telecommunication Office should not prescribe the form of the structure, or the criteria on which to structure the new service in price terms. The Party to Proceedings therefore requested to remove the criterion of line "length" because, as the Party to Proceedings believed, the transmission rate, or capacity, of the leased line terminating segment is fully sufficient. The Party to Proceedings proposes to modify the text of the last paragraph of Part I of the Decision to read as follows: "The Party to Proceedings shall negotiate prices for the different types of leased line terminating segments, the price being structured into a one-off payment for installing the leased line terminating segments and the monthly rate for the lease of the terminating segments of the leased lines, detailed according to transmission rates (line capacity)".

The administrative authority granted this request.

The Party to Proceedings requests that market No. 13 – Wholesale Provision of Leased Line Terminating Segments in Electronic Communication Networks was only defined for the terminal segments of the lines at transmission rates of nx64 kbit/s (2048 kbit/s at the maximum), that are achievable on the Telefónica O2's existing (already built) copper infrastructure. The offering prices for the leased line terminating segments at higher transmission rates (E3, STM-1 etc.) cannot be included in the reference offer because such high-rate terminating segments are not normally comprised within the infrastructure of the Party to Proceedings, and such lease takes the form of a separate project, based on an individual request. Under such circumstances the price for any such line is calculated separately (on the basis of a separate cost calculation), depending on the size of the newly built infrastructure. The Party to Proceedings therefore requested that a separate fifth paragraph be added to Part I of the Decision, which would read as follows: "The Party to Proceedings may negotiate the price on the basis of an individual calculation for the terminating segments of lines at transmission rates higher than 2048 kbit/s, while respecting the principles set out in the third and fourth paragraphs of Part I".

Although the administrative authority's view concerning the changed definition of market No. 13 was different from that held by the Party to Proceedings, the administrative authority examined the request submitted by the Party to Proceedings in this stage of the administrative proceedings and, to meet that request, it complemented the text in Part I of the Decision Ruling so that the leased line terminating segments having transmission rates above 2048 kbit/s were excluded from price regulation, the reason being that lines for such capacities are as a rule installed ad hoc, based on agreement between the parties.

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In Part II of its draft Decision on Price No. CEN/13/XX.2006-Y, the administrative authority sets out the obligation to publish the price within 60 days of the finality of the Decision. Owing to the fact that under Draft Decision No. REM/13/XX.2006-Y a reference offer of access must be published within the meaning of Regulation of General Application No. OOP/7/07.2005-2, laying down the extent, form and mode of publishing information about access to, or interconnection of, electronic communications networks as well as the essentials, extent and form of the reference offer of access and/or interconnection – which must, among other things, also contain an offering price list – the Party to Proceedings considers this period to be too short because at present there is no separate offer for wholesale provision of leased line terminating segments. The opinion of the Party to Proceedings, responding to Draft Decision No. REM/13/XX.2006-Y, contains a number of other relevant reasons for the Party to Proceedings to request that the period for issuing a new reference offer for the provision of leased line terminating segments should be set at 180 days. The new reference offer is also to contain a new price list for that service and, on that basis, the Party to Proceedings requests that the periods should be the same in the two above-mentioned Decisions concerning marked No. 13.

In addition to the above details to be contained in the reference offer it will be necessary to propose a new price list, because its current structure does not comply with the definition of market No. 13. The Party to Proceedings does not at present distinguish, in the wholesale lease service area, between the leased line terminating segments and leased line trunk segments. Such a distinction also implies the need to redefine the calculation of the costs of these services that are separated in administrative terms: they should be calculated within the system of accounting separation of costs and revenues based on Regulation of General Application OOP/4/03.2006-3. For the above reasons, the Party to Proceedings believes it has good reasons to request the period in Part II to 180 days.

In this stage of the administrative proceedings, the administrative authority partly accepted the comment concerning the extension of the period and changed the period in Part II of the Decision Ruling from the initial 60 days to 90 days.

On the basis of Section 130 of the Act and in accordance with the Czech Telecommunication Office's Rules for consultations at the discussion site, the Office published its draft Decision, including invitation to raise comments, at the discussion site on 23 August 2006.

The administrative authority received comments from two entities. The first comment concerned the period for publishing the prices, which was requested to be extended to 180 days.

According to the opinion of the administrative authority, it is impossible to set the period as proposed by the Party to Proceedings in a situation where the Party to Proceedings already carries out some of the obligations imposed hereunder, doing so on the basis of other decisions on the imposition of remedies. The administrative authority does not consider such a length of the period as substantiated and sets the period at 120 days.

The other comment was against limiting the price regulation to lines at transmission rates of up to and including 2048 kbit/s. There also was concern of the possibility of cross financing.

This administrative authority considered this comment and granted the request in this stage of the administrative proceedings (this changed in the subsequent stage of the proceedings).

The above comment and the manner it was addressed were made public in the comment settlement table at the discussion site on 31 October 2006. The administrative authority modified the draft Decision according to the result of the public consultation.

The Party to the Proceedings was given an opportunity to express its view in accordance with Section 122(5) of the Act.

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The Party to Proceedings familiarised with the file on 1 November 2006 and requested a 7-day period to express its opinion. The administrative authority received the opinion of the Party to Proceedings on 8 November 2006. The Party to Proceedings requested that the administrative authority should reconsider the application of regulation to lines at capacities (transmission rates) above 2048, exclude such lines from the regulation and, in Part I Clause 1, add after the words “and reflecting the associated risks” the text “for leased line terminating segments at capacities up to and including 2048 kbit/s (E1)” and in Part I Point 2 substitute the words “different from those determined” for the words “lower than those determined”.

The administrative authority reconsidered the issue of excluding the terminating segments of lines at transmission rates above 2048 kbit/s. This led to a change of the opinion stated in the settlement of the comments from the public consultation. Such lines are installed ad hoc, based on agreement between the parties. As a result, the administrative authority arrived at the conclusion that price regulation in this area would amount to inadequate intervention in contractual freedom. The administrative authority considers the obligation of accounting separation imposed on the Party to Proceedings as sufficient to prevent cross financing.

The administrative authority decided as indicated in the Decision Ruling. 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*]
PhDr. Pavel Dvořák, CSc.
Chairman of the Council of the
Czech Telecommunication Office