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Report of the hearing granted to the interested entities on the draft decision on the offers "PT Timeslots", "PT Destinations" and "PT Groups" from PTC

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I. Framework

The *Autoridade Nacional de Comunicações* (National Communications Authority) (ANACOM) received, on 07/03/03 a complaint submitted by *Onitelecom, Infocomunicações S.A.* (ONI), against a set of new commercial offers, namely:

i) "PT Destinations", which consists in the offer of minute packages for calls in the network of *PT Comunicações S.A.* (PTC) within the national territory and for calls terminating in Spain, the United Kingdom, Germany, France, the United States and Canada;

ii) "PT Timeslots" – "Night and Weekend", "After Hours" and "Part Time" - which consists in the offer of three different minute packages for local and regional calls within the PTC network;

iii) "PT Groups" - "Friends 1 to 1, 1 to 3 and 1 to 10" - which consists in the offer of minute packages for calls within the PTC network, comprising 1, 3 or 10 destinations selected by the user.

Initially, these offers raised concerns as to the possibility of the fixed telephone service providers (FTS), operating by means of indirect access, being able to present similar offers, based on the prices charged by PTC for the interconnection service – the necessary input to the establishment of analogous offers, as that entity has recognised – thus constituting an obstacle to the conditions for a sound market competition.

In the light of the above, on 13/03/03 ANACOM requested of PTC additional information regarding the afore-mentioned offers, namely as to the demonstration of the compliance with the applicable regulatory principles.

In reply to the request presented by ANACOM, PTC submitted a range of comments, by letter dated 20/03/03, on the innovatory features of the offers, the compliance with the principle of cost orientation of prices and the compatibility of the offers with the interconnection prices, established by the Board of Directors of ANACOM on 21/03/03 (see http://www.anacom.pt/template12.jsp?categoryId=59212).

Having analysed the comments put forward by PTC, the Board of Directors of ANACOM approved, by determination of 10/04/03, the likely purport of the decision on the offers under consideration, which was notified to the interested entities, which were entitled to assess the issue if they so wished, pursuant to the Code of Administrative Procedure.

By fax dated 01/07/03, PTC informed that it was finalizing significant reductions on the interconnection prices for the termination of outgoing international traffic, presenting the following expected prices (euro cents per minute) to the relevant destinations, namely, 2, 74 to Spain, France, Germany and the United Kingdom, 3,84 to the United States of America, and 4,39 to Canada.

II. Replies to the Hearing

In the course of the public consultation process, the contributions of *OniTelecom – Infocomunicações, S.A.*, *Novis Telecom, S.A.* and PTC were received at ANACOM.

PTC advised that it did not deem appropriate to suspend or interrupt the marketing of the offers under consideration, regarding "*the launching and maintaining of the offers under analysis to be more acceptable, submitting them, nevertheless, to a monitoring process, carried out by ANACOM*", in order to provide against the risks identified in the draft decision.

The remaining service providers supported the purport of the draft decision, namely as far as the safeguard of the applicable regulatory principles is concerned. One of them suggested that such offers ought to have been temporarily suspended up to the adoption of the final decision on the part of ANACOM, thereby avoiding damage to the new providers.

A summary integrating the replies received is subsequently presented, without prejudice to the individual consultation of the replies submitted by the consulted entities, as well as the correspondent view of ANACOM. The main points identified in the replies received relate to:

ii) The updating and rectification of the information on the draft decision;

iii) The verification of the principle of non-discrimination;

iv) The verification of the principle of cost orientation of prices.

1. Information Updating and Rectification

As regards the analysis of the "PT Destinations Portugal" offer, the draft decision made use of an inappropriate timeslots usage profile (which corresponds to the distribution of calls). The respective rectification having been made, for the consumption of the total of minutes, the package price is higher than the interconnection price in 23% (the draft decision referred a difference of –22%.)

A small rectification was made likewise to the interconnection price regarding single transit termination, as well as to a misprint in the chart concerning the "After Hours" plan (one digit was missing to the figure relating to the "margin as to the interconnection prices with consumption at 50%").

The analysis of the "Friends 1 to 3" plan, the information of which was in the mean while published in the Internet by PTC and subsequently submitted by a provider, was also included, within the context of the hearing granted to interested entities.

The interconnection prices expected for the termination of outgoing international traffic, submitted by PTC on 01/07/2003, were likewise incorporated.

2. Principle of non-discrimination

A) Verification of the principle of non-discrimination

A1) Comments from interested entities

PTC, as far as the usage levels are concerned, has declared that the usage of the total of package minutes does not reflect consumption behaviours, having regard to the fact that "*the amount consumed is not endlessly elastic*" and that the full consumption of minutes would require an unlikely combination of factors.

This entity referred that it was already possible to the remaining operators to achieve positive margins, regarding the interconnection prices, considering the 50% usage included in the draft decision and the fact that these margins would substantially increase if the usage observed up to 01/04/03, below 25%, was to be taken into account. It also referred that *Telefónica*, its counterpart, observed average consumption percentages between 28% and 37% for similar offers. However, PTC acknowledged that the usage levels might expand in the future, having regard to the increasing levels of user adaptation to this type of tariff. In spite of this possibility, the usage rates currently verified allow the remaining operators to obtain higher margins, regarding the interconnection prices, than those presented in the draft decision.

The remaining providers did not agree to the consideration of consumptions of 50% of the traffic engaged, for the purposes of the verification of the principle of non-discrimination, arguing that there are no incentives that impel clients to control minute consumption (until the available number of minutes is exhausted), or that the weight of clients who consume the total of minutes included in the packages is not residual. In this respect, it was stressed that this type of promotions has an impact on the market of professional users and of small offices, with a strong incentive as to the exhaustive use of the available minutes in each package, namely having regard to the particular circumstances of their activities.

It was further mentioned that the impact of offers putting an increasing pressure on retail prices, without a previous change in interconnection conditions, would evolve to a situation of crushed margins, leading in due course to the elimination of alternative providers to PTC.

A2) Position of ANACOM

According to the information submitted by PTC on the current package usage rates, on average, clients that have adhered to the plans “Night and Weekend”, “After Hours” and “Part Time” (afternoon period) would bear higher costs than those that result from the application of that entity’s standard tariff. This fact, which is wholly contrary to the principle of consumer rationality, leads to the conclusion that the initial measurements carried out by PTC are either mistaken or correspond to a transitional circumstance. ANACOM thus takes the view that, in order to assess the verification of the principle of non-discrimination, higher usage rates than those reported by PTC are to be taken into account.

As regards the consumption percentages conveyed by PTC for similar offers to those of its counterpart *Telefónica*, they should be analysed having regard to the specific features of each offer, potential differences of behaviour of the clients of each undertaking and specially the provision on the part of *Telefónica* of plain interconnection tariffs that, on certain price and service quality conditions, may constitute an alternative so that the remaining operators may design offers based on minute packages.

The considerations afore mentioned indicate that the assumption of ANACOM, concerning the integral usage of the minute packages, is quite reasonable, which is besides in conformity with the expectations of PTC that the price plans under consideration would create more intense consumption habits in the adhering clients.

It should be noted that, on the part of the remaining national regulatory authorities of the European Union, no normal, established and uniform practise exists as to the analysis criteria for this type of offers, especially as regards the identification of usage rates. Nevertheless, by way of example, ART, the French regulatory entity of the telecommunications sector, deems 90% as a realistic usage rate, although the historic operator of that country has identified lower usage rates, of around 60%.

However, having regard to the current development stage of the offers, the information available at the moment on the usage levels of the minute packages of PTC, the non-transitivity of unconsumed minutes to the following days and the fact that offers concerning international traffic and traffic on normal timeslots tend to be used more intensely by corporate clients, whereas those concerning economical timeslots tend to be used by residential clients, ANACOM acknowledges, for the purposes of this analysis and without prejudice to a timely assessment of the offer conditions, the following usage:

- 50% of minutes relating to the packages for national traffic during economical timeslots;

- 75% of minutes relating to packages for international calls and packages granted for normal timeslots.

Table 1 presents the comparison between the revenues generated by the price plans under analysis and the minimum prices of the interconnection global service provided by the historic operator.

Table 1: Analysis of the principle of non-discrimination*

	Revenues per Price Plan	Interconnection price with estimated consumption	Margin as to the interconnection prices with estimated consumption
PT TIMESLOTS PLAN			
Night and Weekend (1)	€7.56	€4.46	70%
After Hours (1)	€5.80	€3.11	86%
Part time (2)	€12.61	€8.18	54%
PT GROUPS PLAN			
Friends 1 to 1 (1)	€5.00	€4.70	6%
Friends 1 to 3 (1)	€6.30	€4.70	34%
PT DESTINATIONS PLAN			
Portugal (1)	€5.8	€2.42	139%
Spain (2)	€7.48	€6.12	22%
United Kingdom (2)	€8.32	€6.12	36%
Germany (2)	€8.32	€6.12	36%
France (2)	€8.32	€6.12	36%
USA (2)	€10.84	€8.57	26%
Canada (2)	€10.84	€9.97	9%

* For the purpose of comparison, for local calls, a call origination at local level and a call termination at local level were taken into account; for regional calls, a call origination at local level and a single transit termination were regarded; and for national calls, a local call origination and a double transit termination were taken into account. The distribution of the number of minutes by the different types of calls was made based on their relative weight on the relevant traffic, having regard to the calls of an average duration. VAT excluded. As to international calls, the interconnection prices indicated in point II) 1 were considered.
(1) Usage rate of 50%.
(2) Usage rate of 75%.

Looking at Table 1, it may be concluded that the FTS providers operating through indirect access, for the usage levels considered, have the possibility to present offers competing with the "PT Timeslots", "PT Destinations" and "PT Groups" offers, based on the prices currently charged by PTC for the national interconnection services and on the new interconnection prices submitted on 01/07/03 for the outgoing international traffic.

Within this context, it is of consequence to note that the possibility of the notified operator with significant market power setting retail prices lower than the relevant interconnection prices cannot be taken into account, in the market of the fixed telephone service and/or fixed telephone networks and in the interconnection national market. Promotional offers of a definite and limited duration may be the object of a case-by-case approach.

B) Establishment of Minimum Margins

B1) Comments from interested entities

Two providers have mentioned the need for the establishment of minimum margins to reply to the offers presented by PTC. According to one of the providers, the margin as to the interconnection prices should not be lower than 80%, in order to appropriately remunerate the additional resources involved in the service provision, whereas another declares that the wholesale price should be half the retail price, as provided for in the draft decision prepared by ANACOM concerning the "PT ADSL Network" offer.

B2) Position of ANACOM

PTC, as an entity with significant market power, is bound to offer the conditions and information applied to its own services, subsidiaries or associated companies, to the interconnection applicants that offer similar services and that are in similar conditions, pursuant to article 8 of Decree-Law no. 415/98, of 31/12.

ANACOM takes the view that such conditions should be sufficient so as to allow efficient operators to reply to the offers of PTC, an offer-by-offer analysis of the operational costs incurred by each operator being considered inadequate.

As regards the reference to other draft decisions made by ANACOM, namely those concerning wholesale issues, it should be noted that it is not possible, nor appropriate, to generalize certain rules to specific contexts. Moreover, the levels referred by providers for the establishment of minimum margins are not duly reasoned nor verified.

3. Verification of the Principle of Cost Orientation of Prices

3.1) Comments from interested entities

As far as this principle is concerned, PTC declared that it felt some trouble understanding the objections raised by ANACOM to the comparison of the costs reported for the average client of PTC and the revenues of each price plan. It stressed that the expense model does not provide information as to these offers, having thus adopted as unit of measure the network line/client, assuming that all investments and network costs would be remunerated based on fixed amounts per client, the applicable consumption unit. This assumption would be justified having regard to the preponderance of fixed costs in telecommunication systems and the practise, in the past, of some operators in the USA, who remunerated local calls by means of fixed instalments.

PTC also declared that in the course of the examination of predatory prices "*it would be more appropriate to compare the price with the variable costs*" and that, although the global expense model of PTC does not present this information, it is intuitive that the variable costs are lower than direct costs. Therefore, the use of direct costs for the assessment of the existence of predatory prices would not be entirely adequate.

An alternative provider conveyed the idea that, for the purposes of comparison of the package revenues with the relevant expenses, the costs incurred for the provision of each offer should be considered rather than the costs reported for the average client of PTC. It also referred that the exclusion of current and joint expenses in the analysis of the principle of cost orientation of prices lacks clarification, as well as the non-provision of the usage profiles taken into account in the draft decision.

It was further mentioned that the clients of these offers could not be subsidised by the clients of PTC's base tariff, a situation which would correspond to the non-compliance with the rules of underselling control, transparency, non-discrimination, and cost orientation of prices. One of the providers referred also that the winback activity engaged by PTC clearly affects the conditions of service operation of the remaining providers, and should be therefore prohibited.

3.2) Position of ANACOM

As regards the statement, presented by PTC, that its expense model should not be used to record the costs of the offers under consideration, ANACOM disagrees. Notwithstanding all the known limitations, ANACOM takes the view that the expense model of PTC (based on fully allocated historic costs), may be taken as a basis for cost estimating as to new offers, even if alterations or adaptations should be made.

The principle of cost orientation of prices should entail the ability of the revenue, generated by the minute package, to remunerate adequately the costs of traffic accomplished. The specific approach presented in this case by PTC is thus deemed inappropriate. In fact, the comparison between the revenues gained with a specific minute package and the costs of an "average" client is not justified, and so the verification of this principle should be assessed at the level of established prices and incurred costs for each service or offer. As a matter of fact, this was the principle presiding over the tariff rebalancing.

According to the European Commission, prices that are lower than the average variable costs should be always deemed abusive, in the sense that there is no other economic aim but the restriction of competition, as each unit produced and sold causes injury to the enterprise. Where prices are established below the average total costs, but above the average variable costs, they are to be considered abusive if a restriction plan is demonstrated.[1]

Consequently, acknowledging that the expense model of PTC has not been designed to determine variable costs, ANACOM considers, as regards national traffic, that direct costs may be roughly taken as a proxy for variable costs. As far as the determination of variable costs is concerned, it should be taken into account, also, that there are elements of other types of costs (for example, joint costs) that also present a variable feature, the consideration of which may be reflected in the margins of PTC.

As regards the outgoing international traffic, the average prices estimated for the termination of calls in the fixed networks of foreign operators are considered as proxy. The prices for the first half of 2002 being known, the prices for 2003 have been estimated, based on the developments formerly observed, having regard, for this purpose, to an average rate of a bi-annual average variation of 18%, pondered by the traffic concerning each of the six international destinations of the “PT Destinations” plan.

On the other hand, ANACOM is of the opinion that, concerning offers comprising traffic on economical timeslots, it is permissible to compare the prices with the costs of traffic on economical timeslots. However, the expense model of PTC reports the traffic average cost regardless of the tariff timeslot. Thus, to estimate the traffic cost on the economical timeslot, it was assumed that the relation between that cost and the traffic average cost is the same as the relation between the average price per minute on an economical timeslot and the average price. This average price was calculated by applying the standard tariff of PTC to the calls, assuming also that the average duration is allocated just like a negative exponential function. Based on these assumptions, it was estimated that the direct cost of national traffic on economical timeslots suffers a variation from 62% (for trunk calls) to 88% (for local calls) of the direct cost. A similar assumption was considered to estimate the traffic cost on normal timeslots.

On Table 2, the suitability of offers towards the principle of cost orientation of prices is identified. It may be observed that the prices of the “Friends 1 to 1” and “Friends 1 to 3” minute packages are lower than the costs estimated for the service provision, and should therefore be withdrawn.

[1] See, for example, the glossary of the Directorate General for Competition of the European Commission.

PT TIMESLOTS PLAN	
Night and Weekend (1)	Yes
After Hours (1)	Yes
Part time (2)	Yes
PT GROUPS PLAN	
Friends 1 to 1 (1)	No
Friends 1 to 3 (1)	No
PT DESTINATIONS PLAN	
Portugal (1)	Yes
Spain (2)	Yes
United Kingdom (2)	Yes
Germany (2)	Yes
France (2)	Yes
USA (2)	Yes
Canada (2)	Yes
(1) Usage rate of 50%. (2) Usage rate of 75%. Yes = Complies with the principle; No = Disregards the principle	

III. Conclusions

Having regard, in particular, to:

i) The fact that, pursuant to article 8 of Decree-Law no. 415/98, of 31/12, PTC, as an entity with significant market power, is bound to comply with the principle of non-discrimination as far as interconnection offers are concerned, which entails, namely, an obligation to *offer the conditions and information applied to its own services, subsidiaries or associated companies, to the interconnection applicants that offer similar services and that are in similar conditions*;

ii) The fact that the prices for the access and use of the fixed telephone networks and the FTS, charged by the respective operators and/or providers holding significant market power, should comply with the principle of cost orientation, pursuant to article 34 of the Regulations for the Operation of the Fixed Telephone Service;

iii) The fact that, in the meantime, information on the "Friends 1 to 3" price plan was published on the PTC website; that, likewise, this information was submitted to ANACOM by ONI, and that up to this moment the conditions applicable to the "Friends 1 to 10" price plan are not known;

iv) The fact that the prices for the "Friends 1 to 1" and "Friends 1 to 3" offers do not comply with the principle of cost orientation of prices;

v) The fact that FTS providers, operating by means of indirect access, for the expected levels of use, are able to present offers competing with the PT Timeslots", "PT Destinations" and "PT Groups" offers, based on the prices charged by PTC for the interconnection services for national traffic and on the international interconnection prices submitted by PTC to ANACOM on 01/07/03;

vi) Article 34 of Decree-Law no. 415/98, of 31/12, article 51 of Decree-Law no. 474/99 of 08/11, point n) of article 6 and point g) of article 9, both of the Statutes of ICP-ANACOM, approved by Decree-Law no 309/2001 of 7/12, which constitute the enabling rules for the present provision;

And taking into account also the results of the audience granted to the interested entities, and the respective assessment of ANACOM, the following conclusions were reached:

1) The "Friends 1 to 1" and "Friends 1 to 3" offers are to be withdrawn;

2) PTC shall update the interconnection prices for the termination of outgoing international traffic, established by the Interconnection Reference Offer, within 10 days at the most, emphasizing reductions which shall be not below the ones notified to ANACOM on 01/07/03;

3) PTC shall submit to ANACOM, every three months and providing a monthly breakdown, up to 20th day after each quarter, the levels of use of each package offered or to be offered, in order to safeguard the risks pointed out by ANACOM in the respective draft decision.