Response to Consultation and Notification to European Commission – Retail Fixed Markets

(Response to Public Consultation 01/07)

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Executive Summary

The new communications regulatory framework requires that the Authority define relevant markets appropriate to national circumstances, in accordance with the market definition procedure outlined in the Framework Directive[1].

On 10th April 2007, the Authority issued a national consultation on its market analysis for retail fixed markets (Public Consultation No. 01/07). The Authority received detailed submissions from the two respondents listed below by the close of the consultation period. A third respondent, EasyCall, commented on the general issues in the market, and its views were considered accordingly.

The two detailed responses to the consultation were provided by:

- Gibtelecom
- Sapphire Networks.

The Gibraltar Regulatory Authority (the Authority) thanks all respondents for their submissions. Having considered the views of all respondents, the Authority sets out in this document its final proposals regarding the market analysis process including its SMP obligations and subsequent notification to the Commission and other NRA's in accordance with Article 7 of the Framework Directive.

Market Definition

The Authority proposes to define three retail fixed markets:

- Retail access to the public telephone network at a fixed location
- Retail domestic calls from a fixed location
- Retail international calls from a fixed location.

Market Analysis

In the analysis of the markets, the Authority assessed that Gibtelecom has a 100% market share of the retail fixed access market, 100% market share of the retail fixed domestic calls and 78% market share of the retail fixed international calls[2]. The Authority also considered other characteristics of the market such as barriers to entry, vertical integration, potential competition and countervailing buyer power, and concludes there is little likelihood of these market shares diminishing significantly within the lifetime of this review.

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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 [2002] L 108/33.

2 Gibtelecom response to data request. Public Consultation 01/07 – Retail fixed Markets.

The Authority proposes to designate Gibtelecom as having SMP in the retail fixed access market, retail fixed domestic calls market and the retail fixed international calls market.

SMP Obligations

The Authority identified potential competition problems in the retail fixed markets associated with single market dominance and with horizontal and vertical leveraging. The Authority proposes that SMP obligations are required to address these problems. The Universal Service Regulations[3] and the Access Regulations[4] provide the Authority with a number of obligations it can apply given its preliminary finding of Gibtelecom's SMP in the fixed retail markets.

The fact that Gibtelecom has SMP in the market for retail access to the public telephone network at a fixed location means that the Authority is required, under the provisions of the Universal Service Regulations to impose an obligation enabling subscribers of the SMP operator to access the services of any interconnected provider of publicly available telephone services by dialling a carrier selection (CS) code and by means of carrier pre-selection (CPS). The proposal to impose this obligation is addressed in the wholesale fixed markets review[5].

While the implementation of the Universal Service Regulations makes provisions for SMP obligations in relation to specific end users, the Authority believes that further obligations are also required with reference to the inter-operator processes required to provide CPS facilities. Therefore, the Authority proposes that while the SMP obligation within the Universal Service Regulations imposes the requirement on the SMP operator to provide both CS and CPS products, there is additional justification for supporting obligations to be imposed under the Access Regulations.

The Authority believes that appropriate SMP obligations to address market failure in the retail fixed access market and the retail fixed domestic and international calls market are:

- A price control obligation
- An obligation of no undue discrimination
- An obligation of price publication and notification
- An obligation of cost accounting and accounting separation.

The Authority proposes to impose all of the SMP obligations as of the effective date of the decision.

3 Communications (Universal Service and Users' Rights) Regulations 2006, Communications Act 2006.

4 Communications (Access) Regulations 2006, Communications Act 2006.

5 Public Consultation 02/07 – Wholesale Fixed Markets.

The Authority believes the SMP obligations set out in this market review support the objectives outlined in the Communications Act 2006[6] (the Act) as to how the Authority should exercise its functions. SMP obligations imposed aim to address market failure, to protect consumers against the exercise of market power and to promote competition in the retail fixed markets.

6 Communications Act 2006, Act No. 15, 2006.

1. Introduction

1.1 Background

A new European regulatory framework for electronic communications networks and services entered into force on the 25th July 2003. The framework is designed to create harmonised regulation across Europe and is aimed at reducing entry barriers and fostering prospects for effective competition to the benefit of consumers. The basis for the new regulatory framework is a set of five Directives:

- Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services (the Framework Directive)[7]

- Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities (the Access Directive)[8]

- Directive 2002/20/EC on the authorisation of electronic communications networks and services (the Authorisation Directive)[9]

- Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services (the Universal Service Directive)[10]

- Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector (the Privacy Directive)[11].

These five Directives were implemented as part of the Act. The legislation enables the Authority to carry out reviews of competition in relevant electronic communications markets to ensure that regulation remains appropriate in the light of changing market conditions, otherwise known as market reviews.

1.2 Market review methodology

In conducting a market review the Authority must take account of the SMP procedures in the Act, sections 38-41, as well as the provisions dealing with co-operation with the European Commission and regulatory authorities in the Member States, sections 22-24.

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7 See footnote 1 above.

8 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 (Access Directive) OJ [2002] L 108/7.

9 DIRECTIVE 2002/20/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 7 March 2002 on the authorisation of electronic communications networks and services (Authorisation Directive) OJ [2002] L 108/21.

10 DIRECTIVE 2002/22/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive) OJ [2002] L 108/51.

11 DIRECTIVE 2002/58/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications) OJ [2002] L 201/37.

Section 39 of the Act requires the Authority to take due account of all applicable guidelines and recommendations which have been issued or made by the European Commission in pursuance of the provisions of a European Community instrument. Therefore the Authority should take due account of the Recommendation.

Once the Authority has defined relevant markets, it shall analyse the state of competition within these markets to determine whether or not they are effectively competitive. Where markets are deemed to be effectively competitive or prospectively effectively competitive within the lifetime of the review, any existing regulation must be withdrawn. Where markets are deemed to be uncompetitive, the Authority must consider appropriate regulatory obligations on any undertaking which has significant market power.

The main purpose of a market review is to identify the competitive conditions prevailing in a market by assessing systematically the competitive constraints which are faced by authorised undertakings in the market. A market review commences by defining a market, which is then analysed to assess the degree of effective competition.

In accordance with European Commission Guidelines, the market analysis procedure is prospective – that is, it must be forward-looking.

A market review has three main components:

- Definition of the relevant market or markets
- Assessment of competition in each market, in order to identify competitive constraints and assess whether any undertaking has SMP
- Where market power is identified, consideration of the appropriate SMP obligations in relation to that market.

The European Commission identified a set of product and service markets which may be susceptible to ex ante regulation[12]. The EC is currently consulting on a revised set of markets. Both the initial recommendation and the principles outlined in the current consultation have been taken into account in this review. It should be noted that Gibraltar does not have competition legislation. This is important because any SMP obligations proposed within the communications sector will be regulated only within that sector, there will be no recourse to competition law as there is in other jurisdictions.

It is important to recognise that the markets in this review are already subject to regulation. In order to take this into account, the EC recommends the use of a "modified greenfield" approach, where markets are analysed absent regulation, except when that regulation is not to do with an SMP obligation, or is related to another market. In the retail fixed markets, for example, the obligation to negotiate

12 Commission Recommendation 2003/311/EC of 11 February 2003 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 communication networks and services OJ [2003] L 114/45.

interconnection is given in accordance with section 34 of the Act, hence the reviews will assume interconnection can be negotiated.

The market for retail fixed communications services in Gibraltar

This market review is concerned with connection to the public telephone network for the purpose of making and receiving telephone calls and related services at fixed locations. In the Recommendation the EC identified six retail markets as susceptible to ex ante regulation. These are:

- Two markets for access to the public network at a fixed location, with separate markets for residential and non-residential customers
- Two markets for local and/or national calls at a fixed location, with separate markets for residential and non-residential customers
- Two markets for international calls at a fixed location, with separate markets for residential and non-residential customers.

The Recommendation was the starting point for the Authority's consideration of the particular circumstances of the retail fixed communications services market in Gibraltar.

1.3 Procedure

The Authority has collected market data from the various providers of electronic communications networks and services in order to carry out its market definition and market analysis, based on established economic and legal principles, and taking the utmost account of the Recommendation and the Guidelines.

This market review has drawn on a wide range of date and information to reach its conclusions. The Authority has utilised data supplied by industry and has also referred to comparative data from other jurisdictions.

On 10th April 2007, the Authority issued a national consultation on its market analysis for retail fixed markets (Public Consultation No. 01/07). The Authority received detailed submissions from the two respondents listed below by the close of the consultation period. A third respondent, EasyCall, commented on the general issues in the market, and its views were considered accordingly.

The two detailed responses to the consultation were provided by:

- Sapphire Networks
- Gibtelecom.

The Authority thanks all respondents for their submissions. Having considered the views of all respondents, the Authority sets out in this document its conclusions regarding the market analysis process. All responses received are available for inspection (with the exception of material supplied on a confidential basis) at the Authority's office.

In accordance with section 22 of the Communications Act 2006 and Regulation 16 of the Access Regulations, any proposed measures which the Authority intends to adopt will be made accessible to the European Commission and National Regulatory Authorities in Member States prior to adopting the measure.

1.4 Structure of this document

The rest of the document is structured as follows:

Chapter 2 presents the Authority's preliminary conclusions on the definition of the various retail fixed markets in Gibraltar. This section consists of a review of the market definition procedure, a description of the markets together with the scope of the review.

Chapter 3 presents the Authority's market analysis for the retail fixed markets and outlines a preliminary on whether the markets are effectively competitive and identifies those undertakings having SMP.

Chapter 4 presents a summary of the designation of undertakings with SMP.

Chapter 5 provides a discussion of the general principles associated with the SMP obligations, identifies potential competition problems and outlines the proposed SMP obligations on SMP operators.

Annex A contains the Notification of Draft Measures.

2. Market Definition

2.1 Methodology

The market definition procedures are designed to identify in a systematic way the competitive constraints encountered by providers of electronic communications networks and services. They do so in a way which also facilitates subsequent market analysis procedures. According to the European Court of Justice[13], a relevant product market comprises all products or services that are sufficiently interchangeable or substitutable with its products, not only in terms of the objective characteristic of those products, their prices or their intended use, but also in terms of the conditions of competition and/or the structure of supply and demand for the product in question. In essence, this leads to a definition of the market's boundaries.

Market definition is about identifying the boundaries of a market for the purpose of correctly applying ex ante regulation. The process involves considering constraints arising on both the demand and supply sides of a market (and their interaction). The constraints are those which would apply to a so-called hypothetical monopolist, such that the hypothetical monopolist would be constrained in price setting behaviour. Hence, critical to the market definition process is the degree of substitution identified on the demand and supply-sides of the market.

If there is a lack of current or potential substitutability on either the demand or supply-side of a market, the overall scope of the market will need to be more tightly defined. If substitutability or its potential exists, a broader definition may be appropriate[14]. The competitive status of each relevant market can then be considered.

European guidelines also require the geographic coverage of markets to be considered. A relevant geographic market comprises the area in which the undertakings concerned are involved in the supply and demand of products and/or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighbouring areas because the conditions of competition are appreciably different in those areas.

2.2 Background to the sector

In Gibraltar, access to the public switched telephone network at a fixed location is currently provided by:

- Analogue exchange lines offering low capacity connection, where up to 2 calls can be made at the same time (PSTN analogue or ISDN basic rate access)

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13 See, for example, Case 322/81, Michelin v. Commission [1983] ECR 3461, as well as the Commission Notice on the definition of relevant markets for the purposes of Community competition law ("the Commission Notice on Market Definition") OJ 1997 C 372/3, and the SMP Guidelines.

14 A method for identifying market boundaries is known as the hypothetical monopolist test (also known as the SSNIP test, small but significant non-transitory increase in price test). This test assesses whether a hypothetical monopolist is able to increase price profitably for a product or service.

- High capacity connections where 3 or more calls can be made simultaneously (Digital ISDN exchange lines such as ISDN 30).

However, in determining the relevant market it is necessary to take account of all possible means of access to the end user – this could include copper, fibre, cable, powerline or wireless.

At the end of 2005, there were a total of 24,094 exchange lines[15].

A fixed connection provides access to:

- Outgoing calls to other end-users. These calls may be to fixed or mobile customers, domestic or international locations, or to geographic or non-geographic numbers (for example an ISP, telephone banking and so on)

- Incoming calls from end-users.

2.3 Description of the market

Fixed telephony services in Gibraltar have largely been provided by the incumbent, Gibtelecom, which offers a range of retail access and calls products to residential and business customers. A second operator, Sapphire Networks, was licensed in late 2004. Its service offering to date is principally retail broadband services enabled over Gibtelecom's ADSL lines, and direct ethernet connection to Sapphire's own network, where the customers are within physical reach of its network.

In the market for retail calls, the Authority has carried out a consultation on Carrier Pre-Selection (CPS) and has agreed and determined how it should be implemented in Gibraltar. The timing for the implementation has been delayed pending the outcome of this current consultation, and pending the implementation of the recent commitments expressed in the Trilateral Agreement[16] (the Agreement). Four operators (Gibtelecom, EasyCall, CTS (Gibraltar) Ltd and Transworld Systems Ltd) offer Voice over Internet Protocol (VoIP) calls. However, only the services of Gibtelecom, EasyCall and CTS can be accessed by a Gibtelecom fixed line customer

15 GRA annual report 2005 – 2006 page 21.

16 Electronic communications features significantly in the Tripartite Agreement concluded in Cordoba in September 2006. In the official communiqué the following were stated: "8. In the field of electronic communications, and in order to both address the current limitation on the quantity of telephone numbers in Gibraltar accessible from and through the Spanish network, and also enable roaming agreements between networks in Spain and Gibraltar for mobile telephones, telephone calls from Spain to Gibraltar will be channelled using the technical procedures for international direct dialling recommended by the International Telecommunications Union for all States and territories, including the territory of Gibraltar. In addition, the Spanish network operators will be able to accept the codes assigned to Gibraltar by the aforementioned organization, in order to identify the operators in that territory. These arrangements will become operational within four months of to-day's date, and the 30,000 telephone numbers reserved by Spain in its national numbering plan for access to the Gibraltar network will then be available for reassignment in Spain. Since the introduction of mobile roaming is a matter for the Network operators, the participants shall request from their respective telephone Network operators that, as soon as possible, they enter into appropriate commercial agreements, in accordance with the rules of the free market and in compliance with the EC Electronic Communications Directives (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) and other legal community provisions on electronic communications, all of which have been brought into effect." See http://www.gibraltar.gov.gi/latest_news/press_releases/2006/Official_Documents_Released_After_the_meeting_Cordoba.pdf

by using a three digit access code. Transworld Systems Ltd provide cheap international calls through local call shops open to the general public.

Until the recent Agreement, a major constraint in the development of competition in electronic communications markets in Gibraltar has been the restriction on the quantity of numbers. As Spain did not recognise Gibraltar's International area code (+350), this created a bottleneck, as in order to have direct dialling to Gibraltar, Gibraltar's telephone numbers were treated by Spain as being allocated from the Spanish local exchange in Cadiz. This means that a call to an end user in Gibraltar could be delivered either by calling the Spanish number associated with the Cadiz exchange (from anywhere in the world) or by dialling the Gibraltar IDD international code (from anywhere in the world except Spain).

For example, a Gibraltar telephone number has five digits. The Gibraltar civil exchange uses numbers in the format 4xxxx, 5xxxx, and 7xxxx. The Forces exchange uses sub-levels from 5xxxx and has numbers in the format 53xxx and 55xxx. These numbers are treated by Spain as being allocated through the Cadiz exchange which has the prefix 956 in Spain. Hence, the numbers could be called by dialling +350 xxxxx or by dialling +34 956(7) xxxxx. Mobile telephone numbers are in the format 54xxxxxx, 56xxxxxx, 57xxxxxx and 58xxxxxx. Prior to the commitments of the Agreement, there was a limitation of 30,000 numbers in Gibraltar which could be dialled from Spain. The 30,000 numbers were effectively exhausted.

The lack of available numbers has caused problems both for the incumbent and for any potential market entrants. For the incumbent, for example, there is a restriction on opening up further number blocks for IDD, a service for which it notes demand. For potential entrants, there are simply no numbers available. To some extent, the growth of VoIP can be seen as a response to the lack of available geographic numbers. It is expected that numbering constraints will not be an issue from early 2007 onwards.

2.4 Scope of review

In order to define the boundaries of product and service markets in retail fixed communications, the Authority considered the following:

- Are fixed access and fixed calls in the same market?
- Are retail fixed services in the same market as retail mobile services?
- Are all forms of access in the same market?
- Are all types of voice call in the same market?
- Are residential and non-residential customers in the same market?

In the Consultation the following question was posed:

Are fixed access and fixed calls in the same market?

The Authority proposed that retail fixed access and retail fixed calls are not in the same relevant market. This is because:

- On the demand side, there is no functional substitutability between access and calls. The relationship between the two is complementary and they perform different functions in the eyes of consumers.

- On the supply side, while an access provider may be able to enter the calls market, a calls provider would not easily be able to enter the access market speedily. Where an operator is designated as having SMP in the provision of connection to and use of the public telephone network at a fixed location it is required under the Universal Service Directive to offer Carrier Selection and Pre-Selection (CS and CPS). This could allow entry to the calls market by a service provider using the incumbent's access network infrastructure. This indicates the potential availability of alternative calls products, but not the availability of alternative access products.

Stakeholders were also asked:

Are retail fixed services in the same market as retail mobile services?

The Authority proposed to consider access and calls as separate markets. Therefore it is necessary to examine firstly whether fixed access is in the same market as mobile access, and secondly whether calls from a fixed line should be in the same market as calls from a mobile.

Access

The Authority proposed that fixed access and mobile access are not in the same market because:

- Fixed access is used for services in addition to voice calls, notably internet access (both dial-up and DSL). At this time, fixed internet access is not substitutable by mobile internet access, and in the near future it is unlikely that mobile internet products will offer the functional equivalence to the fixed products[17].

- For both residential and non-residential users, fixed and mobile access are seen as complements rather than substitutes. There are very few mobile-only households – that is, households which have given up a fixed line completely in favour of mobile.

- It is difficult to compare fixed and mobile pricing because of tariff structures, but generally mobile access is cheaper than fixed access, but mobile calls are more expensive than fixed calls.

17 Poor in building penetration for mobile internet is particularly relevant in the densely populated area of Gibraltar.

- Considering supply side substitutability, it is not likely that a supplier of fixed access would switch to supply mobile access, or vice versa, in response to a small but significant price increase because of the cost of providing an access network.

Calls

The Authority proposed that fixed calls and mobile calls are not in the same market. It is suggested that calls from a fixed line and calls from a mobile should be characterised as complementary products rather than substitutes because a user will choose to make a type of call based largely on location. In the Authority's view, there are several reasons why calls from a fixed line and calls from a mobile are in separate markets:

- On the demand side, calls from mobile are generally (but not always) more expensive than calls from a fixed line.
- A defining feature of a mobile call is that it is location-independent, and this cannot be substituted by a fixed call.
- In building penetration of the mobile service is variable.
- Supply side substitution in response to a small but permanent increase is unlikely. This is because an operator of one type of call would have to provide access for the other type of call, either by building infrastructure or by buying the wholesale inputs necessary to offer the other type of call. In Gibraltar, the wholesale inputs are not available and are not likely to be made available within the lifetime of this review, and the sunk costs involved in building an alternative access network makes this option very unlikely.

Interested parties were asked the following question:

Are all forms of access in the same market?

The Authority considered the extent to which different forms of access may be substitutable.

Narrowband vs broadband

While broadband connections are capable of delivering narrowband services, consumers generally switch from narrowband to broadband in order to access higher speed internet services. In Gibraltar, all broadband customers have retained their narrowband connection as well[18]. On the supply side, substitution between fixed narrowband access and fixed broadband access is limited, as a supplier of fixed broadband is not likely to be able to switch readily to supply fixed narrowband services.

18 Response to data request, Gibtelecom.

High capacity vs low capacity

In its latest consultation[19] the EC recognises that NRAs may on the basis of national circumstances segment the market further, and suggests that there may be separate markets for low capacity access and high capacity access. Low capacity access is characterised as access which permits up to 2 simultaneous calls, and high capacity access permits more than 3 simultaneous calls. This would mean that PSTN access and low capacity ISDN, for example, would be substitutes, while high capacity ISDN would be in a separate product market.

The Authority has considered whether there is a single market for low capacity access lines in Gibraltar. On the demand side, low capacity ISDN is functionally substitutable for PSTN access, as ISDN 2 provides similar functionality to two PSTN lines.

If we consider pricing, an ISDN connection, which would provide 2 channels, currently costs £110[20], while a single line connection costs £50. Line rental is currently £6 per month for a single PSTN line, and £24 per month for the ISDN channels (i.e. the equivalent of £12 per channel). This means that while the initial connection fee is in line, the monthly rental is significantly higher – double the PSTN price - for ISDN. This difference in price suggests that low capacity ISDN and PSTN access are not demand-side substitutes at the prevailing prices, because a price increase of 5-10% would not be enough to induce sufficient numbers of customers to switch.

However, a supplier of PSTN access would be able to switch to supply low capacity ISDN access, and vice versa, in response to a small price increase.

In considering whether low capacity ISDN and high capacity ISDN are in the same product market, it is not likely that a customer would consider multiple PSTN lines to be a functional substitute for high capacity ISDN. Generally, high capacity ISDN is used to connect to a PBX, and this could not be achieved by multiples of low capacity connections. Further, the pricing differential between low capacity and high capacity access is significant. This would suggest that low capacity and high capacity access are not demand substitutes.

The EU view of supply issues is that there is generally little supply side substitution between low and high capacity ISDN, because low capacity ISDN supply is linked with the narrowband access network, whereas high capacity ISDN may be supplied directly to a large customer. However, the geographical concentration of Gibraltar means that the spread of the access network is less of an issue, and it is likely that an entity which supplied low capacity ISDN would be able to switch to supply high capacity ISDN and vice versa.

The Authority notes also that the market for high capacity ISDN access in Gibraltar is extremely small, and, in common with ISDN markets throughout Europe, is declining.

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19 Commission Staff Working Document Public Consultation 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 communication networks and services (second edition). Brussels, 28 June 2006 SEC(2006) 837.

20 There is an additional one-off line conversion fee. [source : Gibtelecom website]

In the Consultation the following question was posed:

Are all types of voice call in the same market?

There were two main considerations examined here. First of all, does the destination of the call indicate that it should be in a separate market – for example, should domestic calls be considered as part of the same market as international calls? Secondly, does the form of access matter - are calls made over broadband lines substitutes for calls made over narrowband access?

Domestic/international

There is clearly no demand side substitution between domestic and international calls.

On the supply side, could a supplier of domestic calls switch to supply international calls in response to a small but significant price increase? The supplier of domestic calls would need to obtain an international gateway and agreements with international operators, but is likely to be able to do this. However, a supplier of international calls responding to an increase in the price of domestic calls would not have the domestic infrastructure (i.e. local access network) necessary to offer domestic calls, and is not likely to be able to enter the domestic market. This analysis is absent regulation – it could be argued that if CPS were a mandated obligation, then a supplier could enter the market by purchasing wholesale inputs. This is not currently an option in Gibraltar.

A supplier of international VoIP calls could in theory switch to supply domestic VoIP calls. However, the pricing structure is such that the margin is likely to be too small.

This would suggest that domestic and international calls are not in the same market.

Calls over broadband

The Authority proposed that Voice over Broadband (VoB) calls are part of the retail fixed calls market.

The EC recommends that NRAs consider the extent to which VoB calls are substitutes for narrowband calls by considering a range of factors such as broadband penetration, price elasticity of calls, and the quality of service. The Authority proposed that a VoIP call is a functional substitute for a narrowband call because, to the user, it looks and feels like a retail fixed narrowband call. While there may be a lower call quality for VoIP calls, the Authority does not believe that this would be sufficient to deter switching.

Gibraltar's broadband penetration is currently just under 15% of population. This is above average compared with the EU-15[21]. This means that the infrastructural requirement for VoB (to have broadband access in order to make a VoB call) is sufficiently established.

21 At the end of 2005, the average broadband penetration for the EU15 was 13% of population, or 25% of households. Five member states had penetration rates on or above 15%. Source : Europa website

In terms of pricing, a customer wishing to make a VoIP call needs to have appropriate access – usually a broadband connection and an adaptor. However, the cost of a call is then significantly lower on VoIP[22]. The Authority does not believe that pricing differences would stop customers switching from fixed narrowband to VoIP, and that taking functional characteristics and pricing into account, fixed calls and VoB calls are demand substitutes.

On the supply side, a supplier of fixed retail calls could switch to supply calls over VoB in response to a price increase, relatively quickly and at low cost.

Stakeholders were also asked:

Are residential and non-residential customers in the same market?

Access

The Authority proposed that residential and non-residential customers are in the same market for retail access because:

- The contractual terms of access do not differ significantly between residential and non-residential users, and the pricing structure is the same for residential and non-residential users.
- Operators do not classify different demand categories differently (for example, ISDN access data is collected on a global basis).
- Considering supply side substitution, because the products are the same, a supplier to residential customers could easily divert to the supply of non-residential customers and vice versa.

Calls

The Authority proposed that residential calls are in the same market as non-residential calls because:

- The contractual terms of access do not differ significantly between residential and non-residential users, and the pricing structure is the same for residential and non-residential users.
- Operators generally do not classify different demand categories differently, and do not discriminate between residential and non-residential customers.
- A supplier of calls to residential customers could readily switch to supply non-residential customers in response to a small but significant price increase, and vice versa.

22 For example, a Gibtelecom cheap rate fixed call from Gibraltar to the UK costs 15p/min, while a Gibtelecom VoIP call costs 9p.

2.5 Geographical market

According to established case law, the relevant geographic market comprises an area in which the conditions of competition are similar across the area, and which can be distinguished from neighbouring areas where the conditions of competition are different. The Authority believes that the geographic market for all retail fixed communications access and calls services is Gibraltar. There are no appreciable differences in the conditions of demand or supply within Gibraltar, and similar services are offered on the same terms and conditions throughout.

In Public Consultation 01/07, interested parties where asked the following question:

Q1: Do you agree with the proposed market definitions?

Please give reasons for your answer

All respondents generally agreed with the proposed market definitions. Sapphire Networks acknowledged the fact that the ability to provide a call service independently of access supports the separation of the markets and that Gibraltar's particular circumstance creates quite different market opportunities for domestic and international calls.

With regard to the retail fixed international calls market, Gibtelecom is of the view that VoIP services should be separately identified as a separate market as VoIP call services differ from PSTN call services in terms of characteristics e.g. they are lower quality, they provide only out-going call services and they do not qualify as PATS as they do not provide the customer with the same functionality. Gibtelecom refers to Commission Article 7 letters addressed to the Spanish[23] and Danish regulators[24] which state the reasons why these Member States excluded VoIP services from the retail fixed international calls market and subsequent comments from the Commission.

The Authority's position

The Authority has reviewed its preliminary proposals on whether there should be a separate market for VoIP services in conjunction with the information provided by the respondents. The Authority is aware that some NRAs have decided not to include VoIP calls in their fixed call markets, and has reviewed these submissions and the Commission's response.

The approach recommended by the Commission when assessing whether IP-telephony should be included in any of the retail markets for fixed telephony services indicates that the NRA should examine, taking account of national circumstances, the objective characteristics, prices and intended use of IP-telephony services, as well as their demand-side and supply-side substitution with other fixed telephony services. The NRAs which have decided that VoIP does not constitute part of the fixed calls market largely come to this conclusion on two grounds. First of all, that the

23 EC's comments pursuant to Article 7(3) of Directive 2002/21/EC – SG-Greffe(2005) D/200362 - ES/2005/0326-0329.

24 EC's comments pursuant to Article 7(3) of Directive 2002/21/EC – SG-Greffe(2005) D/206491 - DK/2005/0268-0269.

functionality is sufficiently different between VoIP calls and fixed calls, and secondly, that VoIP has had a negligible impact on the market.

The Authority recognises that VoIP calls have some functional differences from fixed calls. However, it is not necessary for products to be identical to find that they fall within the same product market. The Authority has considered the extent to which a customer making an international call would consider switching from making a traditional fixed call to making a VoIP call, given a small but significant price increase in traditional fixed calls. The Authority's view remains that, in Gibraltar, there is demand substitution between international VoIP and traditional fixed calls.

Following the approach recommended by the Commission the Authority notes the particular circumstances of Gibraltar. The development of VoIP in Gibraltar was in direct response to the issue with numbering discussed earlier in this review. The use of VoIP in this way has led to a more rapid growth than in many other member states, so that just under one third of all international fixed calls are VoIP. This constitutes a significant and stable element of the total market.

The Authority has also reviewed the implications for Gibtelecom's market share of including and excluding VoIP calls. Gibtelecom has 100% share of the non-VoIP fixed international calls market. When VoIP calls are excluded from the market share calculation, Gibtelecom has around 78% of the market for fixed international calls at the end of Q2, 2006. Using the latest figures provided in the data request, VoIP telephone calls represent just over 30% of the total fixed international calls market[25]. The exclusion of VoIP calls would therefore not affect the finding of Gibtelecom's dominance in the international calls market.

The Authority's conclusions are as follows:

- fixed access and fixed calls are in separate markets
- retail fixed services are not in the same market as mobile services
- all forms of narrowband access are in the same market
- domestic and international calls are in separate markets
- VoB calls are part of the fixed calls market
- residential and non-residential calls fall within the same relevant product market
- the geographical scope of the market is Gibraltar.

The Authority therefore proposed to define the following markets:

- Retail access to the public telephone network at a fixed location
- Retail domestic calls from a fixed location

25 The latest figures are taken from quarter 2 of 2006.

- Retail international calls from a fixed location.

In all cases, the proposed geographical market is Gibraltar.

3. Market Analysis

The Authority has identified three retail fixed markets. These are retail access to the public telephone network at a fixed location, retail domestic calls from a fixed location and retail international calls from a fixed location. It is now required to conduct an analysis of whether these markets are effectively competitive by reference to whether any given undertaking or undertakings is/are deemed to hold SMP in these markets.

Under the provisions of Article 14 of the Framework Directive "an undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors customers and ultimately consumers".

Accordingly, an undertaking may be deemed to have SMP either individually or jointly with other undertakings in a relevant market. In addition, where an undertaking has SMP on a relevant market, it may also be deemed to have SMP on a closely related market, where the links between the two markets are such as to allow the market power held in one market to be leveraged into the other market, thereby strengthening the market power of the undertaking.

3.1 Retail Fixed Access

Current situation

The number of narrowband access lines has declined slightly to just over 24,000 over the last two years. ISDN access accounts for a very small proportion of access lines – around 0.5% of overall access and around 2% of business access lines[26]. The number of ISDN access lines has remained fairly stable since the beginning of 2004. Gibtelecom is currently the only provider of retail fixed access and consequently has 100% share of the retail fixed access market.

Barriers to entry

According to the Explanatory Memorandum accompanying the Relevant Markets Recommendation, "...high structural barriers may be found to exist when the market is characterised by substantial economies of scale, scope and density and high sunk costs. To date, such barriers can still be identified with respect to the widespread deployment and/or provision of local access networks to fixed locations"[27].

Should an operator decide to enter the market via direct access, it would require significant investment in an electronic communications network. Most of this will be sunk costs, as such costs will not be recoverable if the entrant decides to, or is

26 Note this assumes that all ISDN lines are for business use – data does not differentiate between residential and business use of ISDN.

27 Section 2.2(i) of the Commission's Recommendation Explanatory Memorandum of the Commission Staff Working Document Public Consultation 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 communication networks and services (second edition). Brussels, 28 June 2006 SEC(2006) 837.

forced to, exit the market. Significant sunk costs create an asymmetry in the market. A potential entrant has to consider whether prices would be high enough to recover sunk costs.

Vertical integration

An undertaking which is dominant at the wholesale level of a market may have the opportunity to leverage market power into downstream markets. In the case of the retail fixed access market, the relevant upstream markets would be those associated with obtaining wholesale inputs, that is, wholesale unbundled access and interconnection.

A vertically integrated operator may enjoy efficiencies arising from its presence in the upstream and downstream markets. Further, a new entrant to the downstream retail market may be dependent on a wholesale input supplied by a vertically integrated operator which is its competitor in the retail market.

Potential competition

A second operator, Sapphire Networks, provides public electronic communications networks and services in Gibraltar. To date, its service offering has been restricted to retail broadband services enabled over Gibtelecom's ADSL lines, and direct ethernet connection to Sapphire's own network, where the customers are within physical reach. Sapphire's offering is primarily for the supply of internet services.

Given the size of the market in Gibraltar, it is unlikely that it would be an economic option to replicate access infrastructure. However, it is possible that a radio network based on WiMax could be established relatively quickly. However, WiMax is used principally for internet access, and so would not necessarily offer the voice and data services offered by a fixed narrowband access line. Nevertheless, WiMax indicates that a radio based network may offer potential competition to the fixed access network.

The other potential means of introducing competition is through the unbundling of the local loop. Local Loop Unbundling (LLU) allows alternative operators to take over the incumbent's local loop, and to assume ownership of the customer relationship and the customer's line.

A Reference Unbundling Offer which would provide for local loop unbundling has been agreed between the incumbent and the regulator. Although the data input to this consultation indicated interest in providing a service based on LLU, the consideration is at such an early stage that the Authority does not consider it will appreciably impact on the level of competition in the market within the timeframe of this review.

The Authority has yet to witness any substantial investment in alternative infrastructure and this leads it to the view that effective competition in the access market is unlikely to emerge over the next two years.

Countervailing Buyer Power

The Authority has considered whether countervailing buyer power (CBP) is an issue in this market. A potential constraint on a supplier's market power is the strength of buyers, if for example a purchaser was sufficiently important to its supplier to influence the price it was charged. In Gibraltar, a purchaser is not able to switch to other suppliers of retail access services, so the potential exercise of CBP is not relevant.

Interested parties were asked the following question:

Q2: Do you agree with the market analysis and proposed SMP designation of the retail fixed access market?

Please give reasons for your answer

All respondents generally agreed with the market analysis and proposed SMP designation. Gibtelecom stated that the Authority had not offered any evidence to support their conclusion that wireless access in the form of WiFi and/or WiMax will not be present within the review's 2 year timeframe; a competitive constraint on their market power in the narrowband access line market. It added that WiFi and WiMax is an access technology which can be deployed in Gibraltar without a very large investment and the chances for its arrival in Gibraltar should not be discounted so lightly.

Sapphire Networks stated that the access network is the most difficult and costly network element to replicate and competition is only likely to emerge to support specific high-traffic customers. It noted that the Authority refers to WiMax as a possible competing technology but added that while this can be established fairly quickly, like all forms of technology it would only be economic if it gained sufficient scale density.

The Authority's position

The Authority notes that an interest has been expressed in introducing WiMax and more recently, since the publication of the consultation, a few service providers are also interested in providing 3G services. However, these interests have not yet amounted to any deployment of alternative infrastructures nor have they resulted in any of the relevant part VI licences purchased. The Authority is therefore of the serious view that even though a new entrant would start providing any of the services mentioned, they would not have a significant impact on the market and would not amount to any competitive constraint on Gibtelecom. Having said this, the Authority also considers that it would be sensible to monitor market developments closely and would undertake a market review at any time in response to significant changing market conditions should it be necessary.

Gibtelecom has 100% of the market for retail fixed access. The Authority has assessed prospective competition and has assessed factors which may qualify Gibtelecom's ability to price independently of any competitors. The conclusion is that Gibtelecom will remain dominant in this market for the lifetime of this review.

3.2 Retail fixed domestic calls

Current situation

Analysis of the data suggests a decrease of around 39% in overall call volume measured in minutes over the last two years[28]. When we look specifically at retail domestic calls, the share of the total calls market accounted for by domestic calls has fallen from 84% to 78% over the same period[29]. This suggests that the fall in the volume of domestic calls accounts for a substantial proportion of the overall decline.

It may be that customers are making fewer or shorter calls, or it may be that customers are making different types of call. During the same period, fixed to mobile calls have increased in volume by just over 27%, but in terms of call minutes, this is not enough to off-set the fall in fixed domestic calls, as fixed to mobile calls account for only 8% of all calls[30].

However, the data indicates a shift from dial-up internet access to broadband. The number of dial-up internet access subscribers fell by 36% from 2004 to 2005, while the number of ADSL subscribers increased by 61%[31]. As dial-up calls to the internet are counted as fixed domestic calls, and ADSL access is not seen as a fixed call, this reduction in the number of dial-up subscribers would bring about a reduction in associated calls, and this is the most likely explanation for the fall in domestic calls.

In calculating the market shares in the domestic calls market, it can be noted that, following the market definition discussed earlier, domestic GSM calls (i.e. calls from a mobile) are not considered to be part of the same market as fixed calls, and so are not included in the market share analysis. Because VoIP calls are considered to be substitutes for fixed calls, they should be included in the market share calculation. However, at present VoIP is used only for international calls from Gibraltar and so there is no domestic VoIP included.

Gibtelecom is the only operator offering domestic calls in Gibraltar, and has 100% market share.

Barriers to entry

Barriers to entry in the fixed domestic calls market are largely associated with the high and non-transitory barriers discussed above in relation to the fixed access network.

An operator could decide to enter the retail domestic calls market either directly, via direct access to customers, or indirectly, by purchasing wholesale inputs. Should an operator decide to enter the market via direct access, it would require significant investment in an electronic communications network. Most of this will be sunk costs, as such costs will not be recoverable if the entrant decides to, or is forced to, exit the market. Significant sunk costs create an asymmetry in the market. A potential

28 Response to data request (Q2 2004 to Q2 2006).

29 Response to data request.

30 Response to data request.

31 GRA Annual Report 2006.

entrant would need to consider whether prices would be high enough to recover sunk costs.

Indirect entry would involve an alternative operator being able to offer a voice calls service over the incumbent's access network. The Universal Service Regulations mandate this principle where an operator is found to have SMP in the retail fixed access market. It could be achieved by offering a variant of carrier selection (Carrier Access, Carrier Select, Carrier Pre-Select), or by offering VoIP calls. None of these options is likely to exist absent regulation.

Vertical integration

An undertaking which is dominant at the wholesale level of a market may have the opportunity to leverage market power into downstream markets. In the case of the retail fixed access market, the relevant upstream markets would be those associated with obtaining wholesale inputs, that is, wholesale unbundled access and interconnection.

A vertically integrated operator may enjoy efficiencies arising from its presence in the upstream and downstream markets. Further, a new entrant to the downstream retail market may be dependent on a wholesale input supplied by a vertically integrated operator which is its competitor in the retail market.

Potential competition

As discussed above, it is unlikely that a new entrant would enter the domestic fixed calls market via direct access.

In the Authority's view, there are two possible indirect routes to offering domestic calls. Firstly, a service provider currently offering VoIP international calls could offer domestic VoIP calls. Secondly, a new entrant could develop a CPS offering. The main barrier to a supplier of international VoIP calls offering domestic VoIP calls is the current tariff structure, where the relatively low cost of domestic fixed calls makes it a less attractive market for a supplier than that for international calls. In the Authority's view, the main reason for a current provider of international VoIP calls not entering the domestic VoIP market is to do with the business case, rather than with any technical or regulatory barriers.

The second means of market entry may be via CPS. This has not been an option in Gibraltar up till now, as the wholesale elements needed to offer a retail CPS service were not available.

Countervailing Buyer Power

The Authority has considered whether CBP is an issue in this market. A potential constraint on a supplier's market power is the strength of buyers, if for example a purchaser was sufficiently important to its supplier to influence the price it was charged. In Gibraltar, a purchaser is not able to switch to other suppliers of retail calls services, so the potential exercise of CBP is not relevant.

Stakeholders were asked the following question:

Q3: Do you agree with the market analysis and proposed SMP designation of the fixed domestic calls market?
Please give reasons for your answer

Sapphire Networks agreed with the analysis and SMP designation stating that any competition in calls would require the availability of appropriate wholesale remedies imposed by regulation. This respondent also agreed that the migration from narrowband to broadband internet access was responsible for the fall in domestic calls and that the migration of voice calls from the traditional PSTN to VoIP using broadband access was also a contributing factor.

Gibtelecom did not consider that the Authority had presented enough evidence to justify its views that competition will not have an impact on this market within the two year review timeframe.

Since the implementation of the recent Trilateral Agreements which resolved the numbering problem, this respondent also claimed that more weight needed to be placed on the recent change in availability of telephone numbers in assessing the likelihood of more competition emerging in the retail fixed markets.

Gibtelecom also stated that in the SMP assessment, the Authority has ignored the threat of potential competition from indirect entry due to new entrants offering voice call services over carrier selection (CS) and carrier pre-selection (CPS). It added that that the Authority is preparing to impose a CS/CPS regulatory regime on Gibtelecom which will make this facility available to third parties wishing to provide retail fixed call services and it should not dismiss the prospect of more competition entering the call service market within the review's timeframe.

The Authority's position

At the time the consultation was published, there was a shortage of telephone numbers in Gibraltar and there is still no alternative fixed network infrastructure in place. Even though the numbering issue has now been resolved, the lack of an alternative access network being rolled out in Gibraltar means that no operator apart from the incumbent can offer any fixed domestic calls[32].

A new entrant could potentially enter the retail domestic calls market by purchasing wholesale inputs from Gibtelecom and offering CPS. The Gibraltar Regulatory Authority has started work on developing CPS in Gibraltar. Due to the extensive work and research which still has to be carried out in preparation for the introduction of a commercial CPS solution by Gibtelecom, the Authority does not believe that CPS services will be in operation before the end of the review timeframe. Having said this, the Authority also considers that it would be sensible to monitor market developments closely and would undertake a market review at any time in response to significant changing market conditions should it be necessary.

32 VoIP providers only offer international call services due to the retail pricing structure for domestic calls.

Gibtelecom has 100% of the market for retail fixed domestic calls. The Authority has assessed prospective competition and has assessed factors which may qualify Gibtelecom's ability to price independently of any competitors. The conclusion is that Gibtelecom will remain dominant in this market for the lifetime of this review.

3.3 Retail fixed international calls

Current situation

In the period 2005-2006, the overall international call traffic volume increased from 11.8m minutes to 17.8m minutes. Just over 30% of call volume was international VoIP[33], and this proportion has remained fairly stable over the last few years. Gibtelecom's share of the VoIP market has decreased over the last year, and Gibtelecom now accounts for around 35% of all VoIP minutes. Gibtelecom has 100% of non-VoIP fixed international calls, so its overall share of the international calls market was 78% at the end of Q2 2006. This represents a decrease from an 82% market share at the same time in 2005.

There are currently four entities offering VoIP calls, namely CTS (Gibraltar) Ltd, Transworld Systems Ltd, EasyCall and Gibtelecom but only CTS (Gibraltar) Ltd, EasyCall and Gibtelecom's[34] services are accessed by dialling a prefix.

Analysis of market share suggests that the alternative VoIP operators are well established, as following initial rapid growth after service launch, their share of the market has remained fairly constant over the last eighteen months.

Barriers to entry

Barriers to entry in the fixed international calls market are largely associated with the high and non-transitory barriers discussed above in relation to the fixed access network.

An operator could decide to enter the retail international calls market either directly, via direct access to customers, or indirectly, by purchasing wholesale inputs. Should an operator decide to enter the market via direct access, it would require significant investment in an electronic communications network. Most of this will be sunk costs, as such costs will not be recoverable if the entrant decides to, or is forced to, exit the market. Significant sunk costs create an asymmetry in the market. A potential entrant has to consider whether prices would be high enough to recover sunk costs.

Indirect entry would involve an alternative operator being able to offer a voice calls service over the incumbent's access network. The Universal Service Regulations mandate this principle where an operator is found to have SMP in the retail fixed access market. It could be achieved by offering a variant of carrier selection (Carrier Access, Carrier Select, Carrier Pre-Select), or by offering VoIP calls. International VoIP calls are already well-established in the market in Gibraltar. None of these options is likely to exist absent regulation.

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33 Response to data request, as at end Q2 2006, Gibtelecom.

34 It should be noted that existing customers of Gibtelecom can use the VoIP service simply by dialling the prefix - there is no requirement to register. Prospective customers of the other VoIP services must register with the service provider.

Vertical integration

An organisation which is dominant at the wholesale level of a market has the opportunity to leverage market power into downstream markets. In the case of the retail fixed international calls market, the relevant upstream market would be that associated with obtaining wholesale inputs, that is, the interconnection markets of origination, transit and termination.

A vertically integrated operator may enjoy efficiencies arising from its presence in the upstream and downstream markets. Further, a new entrant to the downstream retail market may be dependent on a wholesale input supplied by a vertically integrated operator which is its competitor in the retail market.

Potential competition

As discussed above, it is unlikely that a new entrant would enter the international fixed calls market via direct access.

In the Authority's view, there are two possible indirect routes to offering international calls. Two service providers (in addition to Gibtelecom) currently offer international VoIP calls. Other entrants could enter the market in this way. Secondly, a new entrant could develop a CPS offering. This has not been an option in Gibraltar up till now, as the wholesale elements needed to offer a retail CPS service were not available.

The Authority has considered whether the presence of alternative VoIP service providers is likely to constrain Gibtelecom's behaviour over the next two to three years. It is noted that the VoIP providers' market share has not increased in the last eighteen months, and there is no reason to indicate that it is likely to increase now.

Further, Gibtelecom already has around a 30% share of this segment of the international calls market. While the provision of VoIP calls may be competitive in itself, the market which has been defined is the market for fixed international calls. The provision of fixed international calls is not competitive, and although Gibtelecom's market share has declined slightly over the last year, it remains very high. The Authority does not believe that the market is tending towards competition.

Countervailing Buyer Power

The Authority has considered whether CBP is an issue in this market. A potential constraint on a supplier's market power is the strength of buyers, if for example a purchaser was sufficiently important to its supplier to influence the price it was charged. In Gibraltar, it is not likely that a purchaser of international calls services could exercise CBP.

The following question was put to interested parties:

Q4: Do you agree with the market analysis and proposed SMP designation of the fixed international calls market?
Please give reasons for your answer

Gibtelecom is of the view that VoIP services should be separately identified. It added that a consequence of defining VoIP as a separate market would be that in such a market there is effective competition and no VoIP provider can be designated as having SMP.

This respondent also briefly mentioned that the competitive impact of Carrier Selection/Carrier Pre-Selection should be considered in the market analysis.

With regards to international call traffic volume, Gibtelecom provided a different set of figures to those it had supplied to the Authority for the year 2005-2006. The new figures include the first quarter of 2006, and suggest that there has been a decrease in the volume of international calls traffic. Gibtelecom suggests that this could indicate a proportion of VoIP traffic which is not being registered. The Authority notes that if Gibtelecom's hypothesis is correct, then the evidence is strengthened for demand substitution between traditional international fixed calls and VoIP calls.

Sapphire Networks agreed that the competitive situation in this market is quite different from that of domestic calls and was not yet so strong as to suggest any other conclusion than that Gibtelecom has SMP. It added that in any event, absent regulation, what competition currently exists could be squeezed.

The Authority's position

The Authority has reviewed the international call traffic figures and has established the correct figures. The actual figures for the total retail fixed international call traffic minutes are 17.6m in 2004/2005 and 23.9m minutes in 2005/2006 according to the Authority's Annual Reports. These figures were calculated by adding the total international fixed traffic and the total VoIP traffic in both financial years. With these figures in mind, 28% of call volume was international VoIP and this has remained fairly stable over the past few years[35].

The change in these figures has not affected Gibtelecom's share of the VoIP market, which as mentioned earlier represents around 35% of all VoIP minutes. Gibtelecom has around 78% of the market for retail fixed international calls including VoIP calls at the end of Q2, 2006. This represents a decrease from the preceding year, but it is the Authority's view that the market share remains very high. The Authority has assessed prospective competition and has assessed factors which may qualify Gibtelecom's ability to price independently of any competitors. The conclusion is that Gibtelecom will remain dominant in this market for the lifetime of this review.

As regards the competitive impact of CPS on the market, the Authority is of the view that due to the extensive work and research which still has to be carried out in

35 This figure is calculated using the total fixed international call minutes and the total VoIP traffic in the Authority's 2005/2006 Annual Report.

preparation for the introduction of a commercial CPS solution by Gibtelecom, the Authority does not believe that CPS services will be in operation before the end of the review timeframe. See the Authority's position under question 3 above.

4. Designation of undertakings with SMP

Having regard to the sections above, particularly sections 2 and 3 the Authority is of the view that, in accordance with the Access Regulations:

- Gibtelecom should be designated as having SMP in the market for retail fixed narrowband access.
- Gibtelecom should be designated as having SMP in the market for retail domestic calls from a fixed location.
- Gibtelecom should be designated as having SMP in the market for retail international calls from a fixed location.

A reference in this section to any given undertaking shall be taken to include any and all undertakings which are affiliated with, or controlled by, the undertaking in question.

5. Proposed SMP Obligations

5.1 Competition problems in the retail markets

In considering the implications of an undertaking's dominance in a market, the EC Commission notes that:

"dominance is a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of the consumers"[36].

It should be noted that the market review process is not concerned with whether or not there has been a demonstrable abuse of a dominant position. The forward-looking approach recommended by the EC examines the dynamic characteristics of a market, and considers remedying problems that could give rise to or worsen ineffective competition. The concern is therefore with the dynamics of the structure of markets, and not with the behaviour of any particular undertaking.

In a market which is not effectively competitive, an undertaking which is dominant has the potential ability to influence a range of competition parameters, such as prices, innovation, output and the variety or quality of goods and services. Absent regulation, a dominant firm would rationally have an incentive to raise prices above costs, as there would be insufficient competitive pressure to prevent this.

In addition, a firm which was dominant in an upstream market could leverage this market power in the closely related downstream markets. In the retail markets, potential vertical leverage could involve an undertaking which was dominant in the wholesale market – that is, which controlled the wholesale inputs required to offer a retail service – using its dominance to affect competitive conditions in the related retail market.

As well as being able to leverage power vertically from a wholesale market into a downstream retail market, a firm which was dominant in one market could attempt to leverage power horizontally into a related market. In the fixed retail markets, horizontal leverage could include, for example, leverage from the fixed narrowband markets into the fixed broadband markets.

The market analysis which has been carried out in Gibraltar concludes that Gibtelecom should be designated with SMP in the retail markets for fixed access, fixed domestic calls and fixed international calls. The Authority is therefore obliged to consider how best to remedy the lack of effective competition in these markets.

5.2 Principles in determining SMP obligations

Where a National Regulatory Authority (NRA) has made an SMP designation, it is obliged to impose an SMP obligation on the undertaking which has been found dominant. All National Regulatory Authorities (NRAs) have a suite of regulatory tools at their disposal. These are set out in the Access and Universal Service Directive

36 DG Competition Discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, Dec 2005.

which have been implemented in Gibraltar by the Act, the Access Regulations and the Universal Service Regulations.

Article 8 of the Framework Directive sets out the NRA's basic objectives, such that the NRA is required to:

- Promote competition in the provision of electronic communications networks, electronic communications services and associated facilities and services
- Contribute to the development of the internal market
- Promote the interests of the citizens of the European Union.

The NRA must ensure that the proposed obligation best addresses the problem it has identified, and must ensure that any SMP obligation is proportionate to the competition problem it intends to resolve. It is important that any proposed obligation constitutes the least possible burden on the undertaking to which it applies.

It should be noted that there is no recourse to competition law in Gibraltar. This means that the SMP obligations proposed must be sufficient in themselves to address competition problems.

5.3 SMP obligations proposed

The Act sets out the potential SMP obligations which can be imposed where the Authority finds that any undertaking has SMP. Regulations 10 to 14 of the Access Regulations implement Articles 9 to 13 of the Access Directive, and Regulations 14 to 16 of the Universal Service Regulations implement Articles 17 to 19 of the Universal Service Directive. The regulatory options which are relevant for this review of the retail fixed markets are:

- Price controls
- No undue discrimination
- Price publication and notification
- Cost accounting and accounting separation.

The Authority has considered regulatory options in light of its overall regulatory objectives, and in the context of the problems identified in the retail fixed markets.

Under Regulation 16 of the Universal Service Regulations an undertaking which has SMP for the provision of connection to, and use of, the public telephone network at a fixed location is required to enable its subscribers to access the services of any interconnected provider of publicly available telephone services. This may be done:

- On a call-by-call basis by dialling a carrier selection code and

- By means of pre-selection, with a facility to override any pre-selected choice on a call-by-call basis by dialling a carrier selection code.

This is a mandated obligation, and is addressed in the Market Review of the Wholesale Fixed Markets.

In considering each of the regulatory options, the Authority's proposals are as follows:

Price controls

In the consultation, the Authority invited comment on whether it is appropriate to introduce price controls in some or all of the retail fixed markets. The Authority is mindful that there is currently no wholesale or retail competition in the fixed access and domestic calls markets, and no wholesale but some retail competition in the market for international calls. Regulation which is restricted to the wholesale level may be ineffective without supporting regulation at a retail level. It is noted also that there is no competition law in Gibraltar, and so a consideration of the adequacy of this form of regulation is not relevant.

The Authority noted in the consultation that rebalancing of tariffs was not yet complete, and that, in practice, this would mean an increase in the price for line rental, to orient retail access prices towards costs, and a decrease in wholesale interconnection rates. The Authority believes that this rebalancing is objectively justified, and notes that Gibraltar's current line rental prices are amongst the lowest in Europe[37]. However, the costs of domestic and international fixed calls remain relatively high. This is exacerbated by the current billing regime – a move to billing on an actual use basis would be fairer to consumers, and would likely result in lower call charges to consumers.

The Authority accepts that there may be a need to increase retail access prices, but does not consider that this should result in an overall increase in the average consumer's telephone bill equivalent to the level of increase in line rental. This means that the impact of the rebalancing on the average subscriber's bill should be minimal.

As a first step, the Authority proposes to address the issue of the cost of domestic and international calls by requiring Gibtelecom to move to a per second billing regime. The Authority notes that in most European jurisdictions, billing for calls is based on actual use as this is fairer to consumers.

The Authority therefore proposed that an appropriate retail price control to be introduced in the market at this time is a requirement for per second billing.

The Authority invited comment on whether a retail price cap is required on some or all of Gibtelecom's fixed services.

37 Line rental for business and residential subscribers is currently £6 per month.

No undue discrimination

A provider can be said to be discriminating when it applies dissimilar conditions to equivalent transactions. Examples of discrimination may include price offers, information or terms and conditions. For instance, a situation where the SMP operator treats the customers of its own retail service differently from the customers of another provider's retail service by imposing more onerous contractual obligations could be construed as discrimination. An obligation not to unduly discriminate does not mean that there can be no differences in treatment between customers. Rather, it means that any differences must be objectively justifiable, and must not adversely affect competition.

In the consultation, the Authority proposed that Gibtelecom should be obliged not to unduly discriminate between customers.

This obligation should be applied to the following markets:

- Market for retail fixed access
- Market for retail fixed domestic calls
- Market for retail fixed international calls.

Price publication and notification

The Authority proposed that Gibtelecom should be obliged to notify the Authority 60 days in advance of changes to terms and conditions, including prices.

The Authority proposed that Gibtelecom should be obliged to publish changes to terms and conditions 30 days in advance of implementation. As regards tariffs, Gibtelecom will require 30 days notice to publish an increase in tariffs and 14 days for a reduction. Publication should be by prominent notice in the local press and on the company website.

This obligation should be applied to the following markets:

- Market for retail fixed access
- Market for retail fixed domestic calls
- Market for retail fixed international calls.

Cost accounting and accounting separation

The Authority proposed that Gibtelecom should be obliged to maintain updated cost accounting systems which produce appropriate information to demonstrate compliance with cost-orientation.

The Authority also considers that Gibtelecom should be required to make transparent its wholesale prices and terms and conditions. The Authority believes that an obligation of accounting separation is a necessary support for the obligations of transparency and non-discrimination, and helps ensure that there is no unfair cross-subsidy.

In accordance with Regulation 12 of the Access Regulations, the Authority proposes to oblige Gibtelecom to maintain separated accounts.
This obligation should be applied to the following markets:

- Market for retail fixed access
- Market for retail fixed domestic calls
- Market for retail fixed international calls.

Q5: Do you agree with the proposed SMP obligations?

Please give reasons for your answer

Both respondents raised issues regarding the proposed SMP obligations.

Sapphire Networks agreed that the imposition of a retail price cap was justified and that an RPI-x approach would match international practice. Before this is imposed, it believed that call prices and overall profitability of the markets needed to be assessed not only by international benchmarking but also by detailed analysis of what it perceived as the incumbent's super-normal profits.

This respondent also agreed that per-second billing and the price publication and notification timescales were appropriate and in addition suggested that experience from other countries shows that sometimes it is in the public interest to allow price reductions to be offered without undue delay where this is no harm to competitors.

It also suggested that in addition to price controls and CPS, other wholesale remedies such as wholesale line rental (WLR) and non-geographic call origination would be suitable remedies for retail dominance in order to promote the widest competition.

Gibtelecom did not accept the proposed SMP obligations, generally because it believes that tariff rebalancing must be completed before considering any SMP designation or associated remedies. As the company has been unable to complete rebalancing of tariffs, the imposition of a per-second billing requirement was not accepted as it would result in an overall increase in consumers' telephone bills to recover line rental losses. As an alternative to raising the monthly line rental rate, Gibtelecom suggested that it could be possible for rebalancing to be achieved through a slight tariff rate increase plan that recovers the current losses on the local access network.

With regards to the transparency obligation, Gibtelecom accepted the advance publication periods of 30 days for a tariff increase and 14 days for a tariff decrease. However, it suggested to split the 60 days advance notification period for changes to terms and conditions, including prices into two sub-sections. Accordingly, a reduction to 45 days advance notification period for changes in terms and conditions including tariff increases was requested and a reduction to 30 days advance notification period for a tariff reduction. The obligation to publish changes to terms and conditions 30 days in advance of implementation was said to be a very long period but no alternative was suggested.

The Authority's position

The Authority notes Sapphire's proposal that an additional range of wholesale remedies may be required to address Gibtelecom's dominance in the retail fixed markets. However, the Authority is mindful that all remedies proposed must be proportionate and justified. As discussed in the Market Review of the Wholesale Fixed Markets, the Authority considers that the mandated obligation to offer Carrier Selection/Pre-selection (CPS) is a sufficient wholesale remedy at this time. Should an alternative operator propose a service in this market which extended a CPS product to offer WLR, the Authority would examine such a proposal in the light of the proposed obligations.

The Authority maintains its view that wholesale remedies are necessary but not sufficient to address competition problems in the retail fixed markets, and intends to impose retail obligations. The Authority notes Gibtelecom's concern that retail price controls should not be imposed before the completion of tariff rebalancing. However, the Authority notes that a retail price cap was applied to BT during which it rebalanced its tariffs. The Authority agrees that tariff rebalancing is a priority especially when there is more than one fixed network operator in the market, yet this has not occurred to date.

In order to move forward and promote a competitive market, the GRA will impose retail price controls in parallel with tariff rebalancing. The Authority intends that Gibtelecom shall be obliged to move to a per-second billing regime. It is the Authority's view that charging based on actual use is fairer to users.

The Authority intends to impose a retail price cap on some or all of Gibtelecom's retail fixed services. Given the absence of wholesale and retail competition in the markets for fixed access and fixed domestic calls, and the limited competition in the market for fixed international calls, a retail price cap is seen as necessary to ensure that Gibtelecom cannot use its dominance to charge unreasonably high prices. The Authority intends to consult further on which services should be included in a price cap, and on the nature of the price cap mechanism to be applied.

The Authority proposes to use a method which would be simple to apply and would constitute the minimum burden on the industry and the regulator. It is likely that the preferred option would be a cap based on the formula RPI-x.

The Authority does, however, seek to apply a specific price control on Gibtelecom's retention, where retention is that amount of the retail fixed to mobile retail charge it retains. In response to the Authority's consultation on wholesale mobile markets, the issue of retention was raised by Sapphire Networks in connection with the effectiveness of the proposed remedies to be applied in those markets. The Authority is proposing to apply a price control to the termination charge that can be set by Gibtelecom. The purpose of this proposed obligation is to ensure that market power is not exercised in the wholesale mobile voice call termination market to the Gibtelecom network.

However, while wholesale buyers may be protected (which in practice means Gibtelecom) from the setting of excessive termination charges, the remedy does not guarantee that end users will be protected. This is because of the market power that resides in the fixed domestic calling markets. Therefore, to complement the measure taken in the wholesale mobile market, the Authority proposes to apply a price control on retention. It is proposed that Gibtelecom may not set a price for fixed to mobile calls above cost. The cost of a fixed to mobile call comprises two elements: retention plus termination.

The Authority notes that call origination charges in the RIO are 1.8p per minute. Therefore the Authority proposes that the retention can not exceed 1.8p per minute. The termination charge for a fixed to mobile call has been estimated by the Authority at 14.6p per minute standard and 12.96p per minute cheap. Therefore the fixed to mobile retail price should not exceed 16.4p per minute standard and 14.76p per minute at the cheap rate. The Authority notes that the current fixed to mobile prices are 17p per minute in the standard period and 15p per minute in the cheap period. These retail rates round up the underlying costs of the fixed to mobile calls.

In the wholesale mobile review it is proposed that the mobile termination rate be subject to a price control and that the average rate should be no higher than 10.5p per minute from January 2008. Therefore, on average the retail price of a fixed to mobile call should not exceed 12.3p per minute (say 13p per minute rounded).[38] In January 2009 the termination charge will be required not to exceed 9.5p per minute on average. Therefore, on average the retail price of a fixed to mobile call should not exceed 11.3p per minute (say 12p per minute rounded). Similarly in January 2010 the termination charge will be required not to exceed 8.5p per minute on average. Therefore, on average the retail price of a fixed to mobile call should not exceed 10.3p per minute (say 11p per minute rounded).

For the avoidance of doubt the Authority does not propose to include the fixed to mobile retention rate within any other retail price cap that may apply.

After consideration of Gibtelecom's requested changes to lead times, the Authority has decided that the advance notification period of 60 days for changes to terms and conditions, including prices is too burdensome in the context of normal business activity and is therefore amending this obligation. The 60 days advance notification period will now only apply to changes in terms and conditions and price increases and there will now be a reduction to 30 days for advance notification of any price reductions.

The following terms will therefore apply:

<u>Notification</u>

The Authority proposes that Gibtelecom should be obliged to notify the Authority 60 days in advance of changes to terms and conditions including any price increase.

The Authority proposes that Gibtelecom should be obliged to notify the Authority 30 days in advance of any price reduction.

38 The average price will be determined using weights applied to the prices in the Standard and Cheap periods, where the weights will be the previous year's share of revenues.

Publication

The Authority proposes that Gibtelecom should be obliged to publish changes to terms and conditions 30 days in advance of implementation.

The Authority proposes that Gibtelecom should be obliged to publish an increase in tariffs 30 days in advance and 14 days in advance for a decrease in tariffs.

Annex A – Notification of Draft Measures Pursuant to Article 7(3) of Directive 2002/21/EC

Under the obligation in Article 16 of the Directive 2002/21/EC, the Authority, has conducted an analysis of the markets for retail access at a fixed location and retail domestic and retail international calls.

Under Article 6 of the Directive 2002/21/EC, the Authority has conducted a national consultation, contained in document no. 01/07. This consultation ran from 10th April 2007 and ended 11th June 2007. The responses to this consultation have been taken into consideration and the Authority has now reached decisions in market definition, designation of SMP and regulatory obligations, which are contained in document no. 04/07.

The Gibraltar Regulatory Authority hereby notifies the Commission of its proposed SMP obligations consistent with Article 7(3) of Directive 2002/21/EC. These obligations are set out above. There is no Competition Authority in Gibraltar so therefore its views are not relevant here.

Summary Notification Form

Section 1 – Market Definition

Please state where applicable:

1.1 The affected relevant product/service market(s) – Pages 10 to 18

The Authority proposes to define three retail fixed markets:

- Retail access to the public telephone network at a fixed location
- Retail domestic calls from a fixed location
- Retail international calls from a fixed location.

Are these markets mentioned in the Recommendation on relevant markets?

Yes.

1.2 The affected relevant geographic market - Pages 16 to 18

The proposed geographical market is Gibraltar.

1.3 A brief summary of the opinion of the national competition authority were provided

There is no competition Authority in Gibraltar so therefore this section is not relevant.

1.4 A brief overview of the results of the public consultation to date on the proposed market definition (for example, how many comments were received, which respondents agreed with the proposed market definition, which respondents disagreed with it) – Pages 16 to 18

Detailed responses to the consultation were provided by:

- Gibtelecom
- Sapphire Networks.

There was overall agreement among respondents on the market analysis and proposed SMP obligations. Some market definitions were disputed yet no strong alternatives were brought forward. Overall, the proposed conclusions remained unchanged after the consultation.

1.5 Where the defined relevant market is different from those listed in the recommendation on relevant markets, a summary of the main reasons which justified the proposed market definition by reference to Section 2 of the Commission's Guidelines on the definition of the relevant market and the assessment of significant market power, and the three main criteria mentioned in recitals 9 to 16 of the recommendation on relevant markets and Section 3.2 of the accompanying Explanatory Memorandum

Not applicable.

Section 2 – Designation of undertakings with significant market power

Please state where applicable:

2.1 The name(s) of the undertaking(s) designated as having individually or jointly significant market power – Pages 29

- Gibtelecom should be designated as having SMP in the market for retail fixed narrowband access
- Gibtelecom should be designated as having SMP in the market for retail domestic calls from a fixed location
- Gibtelecom should be designated as having SMP in the market for retail international calls from a fixed location.

2.2 The criteria relied upon for deciding to designate or not an undertaking as having individually or jointly with others significant market power – Pages 19 to 29

- Market Share
- Barriers to entry
- Potential Competition
- Countervailing Buyer Power.

2.3 The name of the main undertakings (competitors) present/active in the relevant market – Page 9

- EasyCall
- CTS.

2.4 The market shares of the undertakings mentioned above and the basis of their calculation (e.g. turnover, number of subscribers) – Page 25

The following market shares have been calculated using number of call minutes.

Gibtelecom has 100% market share in the retail access market and the retail fixed domestic calls market. Gibtelecom has 78% of the market for retail fixed international calls.

EasyCall has 13% of the market for retail fixed international calls.

CTS has 9% of the market for retail fixed international calls.

2.5 Please provide a brief summary of the opinion of the national competition authority, where provided

There is no competition Authority in Gibraltar so therefore this section is not relevant.

2.6 Please provide a brief summary of the results of the public consultation to date on the proposed designation(s) as undertaking(s) having significant market power (e.g. total number of comments received, numbers agreeing/disagreeing) – Pages 19 to 29

Detailed responses to the consultation were provided by:

- Gibtelecom
- Sapphire Networks.

There was overall agreement among respondents on the market analysis and proposed SMP obligations. Some market definitions were disputed yet no strong alternatives were brought forward. Overall, the proposed conclusions remained unchanged after the consultation.

Section 3 – Regulatory Obligations

Please state where applicable:

3.1 The legal basis for the obligations to be imposed, maintained, amended, or withdrawn (Articles 9 to 13 of Directive 2002/19/EC (Access Directive)) – Pages 30 to 37

The Communications (Access) Regulations transpose Articles 9 to 13 of Directive 2002/19/EC (Access Directive):

- Transparency – Regulation 10
- Non-discrimination – Regulation 11
- Accounting Separation – Regulation 12

- Access to, and use of, specific network facilities – Regulation 13
- Price Control and Cost Accounting – Regulation 14.

The Communications (Universal Service and Users' Rights) Regulations transpose Articles 17 and 19 of Directive 2002/22/EC:

- Regulatory controls on retail markets – Regulation 14
- Carrier Selection and Carrier Pre-Selection – Regulation 16.

3.2 The reasons for which the imposition, maintenance or amendment of obligations on undertakings is considered proportional and justified in the light of the objectives laid down in Article 8 of Directive 2002/21/EC (Framework Directive). Alternatively, indicate the paragraphs, sections or pages of the draft measure where such information is to be found – Pages 30 to 37

This information can be found under section 5 of this document.

3.3 If the remedies proposed are other than those set out in Articles 9 to 13 of Directive 2002/19/EC (Access Directive), please indicate which are the 'exceptional circumstances' within the meaning of Article 8(3) thereof which justify the imposition of such remedies. Alternatively, indicate the paragraphs, sections or pages of the draft measure where such information is to be found

Not applicable.

Section 4 – Compliance with International Obligations

In relation to the third indent of the first subparagraph of Article 8(3) of Directive 2002/19/EC (Access Directive), please state where applicable:

4.1 Whether the proposed draft measure intends to impose, amend or withdraw obligations on market players as provided for in Article 8(5) of Directive 2002/19/EC (Access Directive)

Not applicable.

4.2 The name(s) of the undertaking(s) concerned

Not applicable.

4.3 Which are the international commitments entered by the Community and its Member States that need to be respected

Not applicable.