

Appendix II



POST AND TELECOM
ADMINISTRATION
IN ICELAND

Conclusions from PTA consultation on Draft Decision with respect to the Mila ehf. cost analysis of tariff for lease of facilities (hosting)

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1 Introduction

This document contains an overview of the replies and comments received in the Post and Telecom Administration (PTA) consultation on the Preliminary Draft Decision on cost analysis for lease of facilities in buildings and masts. The initial draft was presented to stakeholders for consultation on the Administration's website on 28 January 2014 and the consultation was thus concluded last 21 February.

The following parties submitted comments on the Preliminary Draft.

- Fjarskipti ehf. - hereafter named Vodafone
- The Icelandic Federation of Labour - hereafter ASI
- The Telecommunications Fund

Comments are categorised by subject. Endeavours have been made to identify all significant comments and to answer them. At the end of each comment there is a short summary of the position of the PTA.

Because of the nature of the comments that came from Vodafone they were sent to the Mila for comments.

2 Mila cost analysis

2.1 In general on the Mila cost analysis

Vodafone refers to the cost analysis where it is stated that Mila leases hosting in 540 buildings and equipment space and about 400 masts. Some of the equipment spaces from which Mila has revenue are owned by other parties and that space was solely leased to Siminn and within Mila.

Vodafone considers that it needs to be specifically examined whether the arrangement in the Skipti Group, where specific hosting locations are only on offer to the Group, harmonises with the Electronic Communications Act with respect to a company with significant market power and Vodafone also considers that the impact of this arrangement on the price for hosting available to all, needs to be examined.

In the opinion of Vodafone the principle of non-discrimination is seriously compromised in the above specified instance and Vodafone believes that it is important for the PTA to assess the Skipti Group arrangement from the point of view of electronic communications legislation.

In the Mila response to comments from Vodafone, Mila denies that the company had rejected lease of facilities in space controlled by Mila as suggested by Vodafone in its comments. Mila pointed out that although it had been stated that some of the equipment space was owned by other parties and solely leased by Mila and Siminn, this did not mean that Mila had limited in any way access for others to that space. The Mila website shows more than 570 equipment spaces to which Mila customers can have access and these spaces are among them.

Mila had not denied any customer access to hosting without valid reason. Last autumn Mila denied Vodafone hosting in Skyggnir. The reason was that subsequent to inspection, the premises were deemed unsuitable for leasing as the electricity was not in order. Had those premises been removed from the analysis, this would have led to an increase in the price of leasing of premises as these premises were operated at a profit.

There are 14 spaces in the analysis that are not shown on the website and they are mainly spaces leased by the National Emergency Number. It is only Mila that leases these spaces. Had these spaces been removed from the analysis the lease price would also have increased as the draft tariff shows that there is also a profit from the spaces.

The position of the PTA

The PTA agrees that it is important to respect the principle of non-discrimination. Should Vodafone consider its rights to be infringed, the PTA proposes that Vodafone

submit a formal complaint to this effect which would then be handled in a specific complaints case.

In their response Mila specified that on their website is a list of over 570 equipment spaces which customers have access to. This is a higher number of spaces than was indicated in the cost analysis and the PTA therefore requested further clarification of this. In their response, Mila stated that the list that appears on the internet has not been updated; some spaces have been closed and/or sold, but still appear on the list. Also, some spaces are counted twice, bear no cost, have just been installed etc. Mila intends to publish soon a new and updated list. Mila confirmed that the operating costs as indicated in the cost analysis, is correct and corrections due to this were not necessary.

Vodafone points out that the cost analysed prices are the official prices for hosting facilities that are open to all parties. Costs incurred by operating hosting locations that are only accessible to the Skipti Group do thus not belong in the cost analysed tariff for hosting in the opinion of Vodafone. Vodafone considers it unacceptable that Mila should include such costs in the calculation model for hosting prices as these are hosting locations that are significantly more expensive to operate than other hosting locations. Vodafone concludes that conduct of this manner results in cost analysed prices for hosting being significantly higher than they would be otherwise.

In addition to this, Vodafone considers it of great importance that the PTA examine the above specified arrangement from the point of view of the provisions of the Electronic Communications Act and that the PTA examine the impact of costs of hosting locations that are only accessible to the Skipti Group on the cost analysed hosting prices for hosting locations that are available to all.

In the Mila response it was stated that a total of 15 spaces were included in the cost analysis without them being accessible to all parties. Mila points out that had these spaces been removed from the analysis then the hosting price would have risen. According to the draft tariff now available the profit from the spaces is approximately ISK [...].

The position of the PTA

As was stated in the Mila response there are 15 spaces in the cost analysis to which access is not currently provided. In the opinion of the PTA it is necessary for all hosting locations to be in the Mila cost analysis, regardless of whether one or more parties use the facilities in question. One should keep in mind that the Mila price for leasing facilities applies regardless of whether this was for internal or external sales.

2.2 Division of opex between areas

Vodafone commented on the cost which is considered to be by far the largest constituent in “other costs” in the analysis, that is to say telephone costs at hosting locations. Vodafone doubts that there is much need for the telephones in question at the Mila hosting locations and doubts that it is normal to impose such cost on other

electronic communications companies. Should it not be possible to demonstrate its importance, Vodafone proposes that it be discontinued and that the costs of hosting be correspondingly reduced.

In addition to this Vodafone considers it to be open to interpretation what should be included in maintenance costs for the emergency response alert phase and that the PTA needs to define this more clearly. Vodafone points out that when a specific alert phase has been declared, for example with respect to volcanic eruption and avalanches, all electronic communications companies are obliged to secure the services they offer. Costs incurred in this process are totally borne by the companies themselves. Vodafone doubts that it is fair that other electronic communications companies also have to bear Mila costs for analogous measures to secure its services.

In the Mila response, Mila points out that a fixed line telephone connection in equipment space is part of the Mila security policy. In the event of a major disruption of electronic communications connections, for example subsequent to a storm or other natural catastrophe, Mila considered it important to have a telephone connected into the equipment space. When there is no connection such as subsequent to the earthquake of 17 June in 2010, mobile phone connections can be lost while fixed line connections remain active. In the opinion of Mila it is extremely important that those working on repairs can be connected to the outside world particularly in the case of spaces in remote areas and in the event of natural catastrophes. It is important to point out that this cost is an insignificant part of the total cost of hosting, approximately ISK [...] per annum. Mila also considers it to be quite absurd to maintain that Mila should bear this cost alone. This cost is for the benefit of all parties in the buildings and is therefore a normal part of building opex, analogous to reserve generators and building surveillance systems, and there is the consideration that at all hosting parties have access to these telephones.

The position of the PTA

The PTA accepts the Mila view that a fixed line telephone connection in equipment space is a normal precautionary measure while there is no other more economic manner in which to ensure an equally secure connection. The PTA therefore considers there to be no reason to remove this cost from the cost model and in addition to this it represents only a small proportion of the total cost of hosting facilities.

Vodafone comments on the hosting category “halls” which was previously called “mixed market”.

In the opinion of Vodafone it would be proper to divide the category “halls” into at least 2 categories, on the one hand “larger halls” and on the other hand “smaller halls”. Larger halls would, in the opinion of Vodafone, be more developed hosting halls (data centres) where there would be more specifications for electricity uptime, ventilation and for matters relating to access and security. The operation of such halls would entail higher opex than the operation of smaller halls. Smaller halls would be

hosting locations such as for example Smárahvammur which is a small telephone exchange with fewer requirements for electricity uptime, ventilation, matters relating to access and security.

Data centres ¹ would be halls that are only available to the Skipti Group while smaller halls ² would be those that are available to other parties on the market. An altered arrangement would ensure that electronic communications companies do not specifically pay for Skipti Group facilities in data centres but rather that they would pay a correct and lower price for the hosting facilities available to them. The methodology of defining all halls in the same category only represents subsidy of hosting fees for the Skipti Group which in the opinion of Vodafone is not normal.

In the Mila reply, Mila points out that there are only 7 spaces defined as halls and these are the spaces that are largest and that offer most possibilities and more varied hosting than other locations. Smárahvammur is not classified as “halls” but as “urban area”. Mila points out that the reference to hosting leased by Siminn does not apply here as it is not part of the Mila hosting and thus not part of the cost analysis for hosting.

Mila emphasises that all of Mila’s customers can lease hosting in halls while there is space, but this varies according to halls.

The position of the PTA

As is stated in the Mila response there seems to be a misunderstanding with Vodafone regarding equipment space which is categorised under the name “halls”. The lease price in halls is lower than in other categories and this is the result among other things of better use of these locations than of other hosting locations in urban areas. On the basis of the information available to the PTA, it is the Administration’s assessment that there is no subsidising of hosting fees for Skipti Group with the hosting fee in halls.

¹ Vodafone refers to á Siminn web address where Siminn equipment halls are described: <http://www.siminn.is/thjonusta/upplýsingataekni/radgjof/vottanir-og-serthekking/>

² Vodafone refers to á Mila web address where a list of Mila equipment spaces is provided: http://www.mila.is/servlet/file/Vi%C3%83%C2%B0auki+4_T%C3%83%C2%A6kjary%C3%8C%C2%81mi+Mi%C3%8C%C2%81lu_okt_2013.pdf?ITEM_ENT_ID=19897&COLLSPEC_ENT_ID=2

2.3 Mila investments in hosting

Vodafone refers to the cost analysis where it is stated that in the last cost analysis from the year 2010 a number of buildings owned by Mila had been lacking and in addition to this two buildings had been counted twice in the model. Vodafone requests further information on the buildings to which Mila was referring in order to be able to assess whether the buildings in question had had an impact on hosting costs.

Vodafone points out, with respect to space for a container for a reserve generator at Ármúli 31, that the Siminn hosting hall is located at Ármúli 31 and that it is not available to parties other than those in the Skipti Group. Vodafone thus considers it to be abnormal that the costs incurred for developing the space be included in the calculation model for hosting prices.

Vodafone also requests further information on the reserve generators that were not in the 2010 model, particularly for the purpose of assessing whether the generators in question had an impact on hosting costs. It is clear that the costs related to reserve generators can amount to hundreds of thousands on an annual basis and it is thus important to ensure that these are only reserve generators for hosting facilities that are open to all parties.

In Mila's response, Mila points out that the information requested by Vodafone with respect to calculations of building costs is confidential. In Appendix 4 to the reference offer for Mila hosting one can find a list of the spaces belonging to the cost analysis. As stated in the Mila cost analysis, calculations have been made using the same methodology as in the previous analysis.

Vodafone is however correct in saying that the container for the reserve generator is for Ármúli 31 but that space is in other respects not part of Mila's hosting. The annuity of this investment is ISK [...] and should not have been included in the cost analysis.

The reserve generators which were added to the cost analysis from the previous analysis were reserve generators at Akureyri, Þorbjörn, Breiðholt and Viðarfjall. Mila owns a 50% share in reserve generators at Þorbjörn and Viðarfjall and this was taken into account in the calculations.

The position of the PTA

As stated in the Mila response, the Vodafone comment with respect to the reserve generator at Ármúli 31 is correct and this cost should not have been included in the cost model, see further in Section 3 here below. As regards the houses that were missing in the previous analysis and the houses that were counted twice, in the opinion of PTA the impact of this on the current tariff is insignificant with respect to the scope of this operation and within reasonable error margins. Cost analysis as discussed here includes a number of factors which may cause errors, such as criteria for assessments, the number of service units and cost centers.

2.4 Cost for Highway Tender GSM 1

Vodafone refers to the consultation document with respect to calculation of opex and notes that costs for buildings belonging to the Highway Tender GSM 1 were deducted. Vodafone objects to the fact that Mila should include buildings that belong to the Highway Tender GSM 1 as Mila assets.

Buildings belonging to “Highway Tender GSM 1” are Siminn assets according to Vodafone information. Siminn was the company which made the tender in question and reached agreement with the Telecommunications Fund on the basis of the tender. That agreement prescribes, to the best of Vodafone’s knowledge, that it is not authorised to sell assets while the agreement is in force. Vodafone cannot conclude otherwise than that in the Mila discussion, the company considers that it owns the buildings in question which would constitute transfer of ownership by Siminn and thus a breach of the provisions of the agreement. The reason why Vodafone objects to the Mila position is that were the company’s rights of ownership recognised then this would mean that in the next reference offer Mila could include the assets in question in its calculation model and thus increase hosting costs in excess of their current level. This is not normal in the opinion of Vodafone, particularly in the light of the fact that the Telecommunications Fund has now paid for the buildings in question.

The position of the PTA

It is not within the scope of authority of the PTA to decide on whether Mila or Siminn own the buildings and masts that belong to the Highway Tender GSM 1. It is however clear that these facilities have been operated by Mila for several years within the Skipti group, which include both Siminn and Mila.

In the opinion of the PTA the Mila tariff for hosting in these buildings and masts is covered by PTA price control in the same manner as other hosting categories when the agreement with the Telecommunications Fund for this tender expires. The PTA expects that the tariff for this hosting will be based on Mila costs for this hosting having taken into account the contribution by the Telecommunications Fund for the development of these hosting facilities.

The Telecommunications Fund considers it appropriate in calculation of costs on which the Mila public tariff is based, that costs belonging to the telecommunications Highway Tender should be deducted. The Decision by the Administration with respect to the Mila cost analysis thus does not cover the subsidised locations in question. For this reason the Telecommunications Fund does not object to this Decision by the Post and Telecom Administration.

The Telecommunications Fund considers it important that fees for hosting, particularly in sparsely populated areas and in uninhabited areas, neither inhibit competition nor the objectives of the Telecommunications Plan for distribution and quality of telecommunications. The Telecommunications Fund considers that it is not given that Mila ehf., or other hosting parties which own and operate an electronic communications facilities that are built and operated with public money, can avoid submitting their tariffs to the Administration.

The position of the PTA

The PTA confirms this understanding of the Telecommunications Fund that this cost analysis here under discussion does not cover hosting locations in the Highway Tender GSM 1.

As stated here above, the PTA considers that the Mila tariff for hosting in buildings and masts that was subsidised by the Telecommunications Fund are subject to price control by the PTA in the same manner as the company's other hosting locations.

3 Conclusion of the cost analysis

Vodafone indicates Mila's wording on page 22 in the consultation document where it states:

“The conclusion of the cost analysis for 2010 was that calculated revenue should be to the amount of ISK [...]. Given that conclusion the requirement for an increase is [...]. Revenue for June 2013 is [...]”

Vodafone asks how the PTA envisages development in these matters, should for example there be development by other parties to the electronic communications market. Whether Mila can always increase its costs to ensure that company revenue will not be less than it “should be”. Vodafone points out that if the Mila leasing price is too high then companies will seek other solutions to ensure economic operations. One avenue for companies would be for them to build up their own hosting locations. Should companies start to build their own hosting locations in the same areas as Mila then Mila could increase the price of other hosting locations and thus prevent savings that could be achieved by other electronic communications companies by building their own facilities.

Vodafone considers it important that the PTA harmonise these considerations, achieve moderate leasing prices and encourage sharing of facilities and thus obviate the need for companies to embark on development of their own hosting facilities in order to avoid excessive hosting prices.

In the Mila response Mila points out that it is for the PTA to decide the structure of cost analysis. Mila however reiterates its view, which has often been stated, that the company objects to being obliged to operate unprofitable locations at low prices. One must take into account the fact that the company is a private company in a competition environment which must achieve normal returns on its investments.

The position of the PTA

With the PTA Decisions no. 26/2007 on the market for local loops, no. 8/2008 on the market for wholesale broadband access and 20/2007 for leased lines etc., obligations were imposed on Mila for access to facilities and for price control. Price for access was to be based on historical costs. This means that the cost analysis being examined

in this instance is based on Mila costs for the provision of the service in question. In the market analysis for Markets 4 and 5 which is being processed by the PTA, the Administration has proposed that the obligations imposed on Mila for access to facilities and for price control be maintained. The PTA thus does not plan to change the arrangement where the tariff for hosting is related to the cost of providing the service.

In connection with the work on the prior Mila cost analysis from 2010 a reassessment was made on investments in buildings, support systems and facilities. The cost analysis under discussion here is based on this reassessment which is in accordance with Regulation no. 564/2011 on accounting and cost analysis in the operations of electronic communications companies. In the light of this fact the PTA considers that investment costs on which the conclusion is based with respect to price for hosting which was published in the consultation document give a realistic picture of replacement cost of the hosting locations that are used for lease of facilities. The above acts as restraint on Mila as the company may not base its conclusions solely on its own costs when deciding prices. Furthermore, the PTA considers the development of total costs of this operation at Mila in comparison with the development of prices in general.

It is appropriate to note in this connection that the Act on the Post and Telecom Administration specifies in point 2.b., article 3, that the PTA should encourage efficient investment in infrastructure and should support innovation. Should measures taken by regulatory authorities lead to a situation where a party such as Mila did not succeed in recovering costs that have verifiably been incurred with efficient investment in infrastructure, then this will have a negative impact on incentives for the company to make further investments. PTA is however authorised to reject costs that the Administration considers to have resulted from uneconomical investments.

Vodafone points out that in the Mila tariff, the price for the first space for optical cable closures 60x60x220 in halls is ISK 8,700 and in urban areas ISK 10,700. Vodafone considers the above price for optical cable closures to be far too high. Vodafone considers the space that Mila considers necessary for optical cable closures to be exaggerated and that facility lease is inexpensive as the space is often located for example in cellars and cupboards. The price for each and every optical cable closure should thus be far below the price specified. Vodafone requests that the PTA particularly scrutinise the calculation by Mila that is used to justify the price given.

In the Mila response, Mila states that the company disagrees with Vodafone's opinion that the price for optical cable closures is far too high. In cost analysis, the objective is to distribute costs in as fair a manner as possible. It is therefore normal that those parties renting space for optical cable closures participate in the cost of operating the premises in the same manner as other renting parties. It is not true that optical cable closures are most frequently in cable cellars or cupboards. In most buildings where optical cable closures are installed there are no cellars and optical cable closures in most instances share space with other hosting.

Furthermore Mila considers it appropriate to indicate to Vodafone that if this leasing price were to be reduced then the leasing price of other hosting would increase, and Vodafone has never leased space for optical cable closures.

The position of the PTA

In the Decision of the PTA no. 41/2010 it was the PTA conclusion that a 0.5 standard unit should be used for each facility for optical cable closures. The PTA applied an assessment which was based on the location and use of space of GR optical cable closures in Mila space and that the same requirements were not made for such space as for traditional leased space, for example with respect to refrigeration, location in space etc.

The PTA considers that no criteria have emerged that would require a change to the above specified assessment by the Administration and in addition to this no complaints have been received to this effect from parties leasing facilities for optical cable closures.

Vodafone considers that the increases notified by Mila for facilities in masts are too high and Vodafone considers that the Post and Telecom Administration needs to carefully examine how these increases have been arrived at. Vodafone considers that increases of this nature will mean that other electronic communications companies will be forced to seriously consider whether it would be more economical to develop their own electronic communications masts and in this way prevent sharing at electronic communications locations, with attendant visual pollution.

The position of the PTA

The current Mila tariff is based on cost analysis from the year 2009. It is estimated that total Mila revenue from leasing will increase by about 8.2% on an annual basis, given revenue according to the current tariff. Lease revenue from houses increase by about 8.1% and lease revenue from masts will increase by 8.6%.

By comparison one can mention that from December 2010 until December 2013 the building price index increased by about 18% which means that the increase is significantly less than the index increase for the period. In the light of this fact the PTA does not consider there to be reason to believe that the proposed increase is abnormally high.

Vodafone considers it important that the Post and Telecom Administration carefully scrutinise the Mila cost model and the items that it includes. It is important to ensure that costs related to the price of hosting are not included that belong to hosting locations only on offer to the Skipti Group and not to other electronic communications companies. It is not normal that Vodafone and other electronic communications companies pay the cost of operation of larger and more technically developed hosting locations to which they have no access.

Mila accepts the Vodafone assertion that 15 buildings that are not on the Mila website should not be included in the analysis and that nor should the container for reserve generator at Ármúla 31 be included. This results in unregistered costs to the amount of ISK [...] if one takes into account profit from these 15 buildings and annuity of the reserve generator. Mila proposes that as this amount is only a small fraction of total costs that the conclusion of the cost analysis be allowed to stand.

The position of the PTA

As mentioned above it is, in the opinion of the PTA, necessary for all hosting locations to be in the Mila cost analysis, regardless of whether one or more parties use the facilities in question. One should keep in mind that the Mila price for leasing facilities would apply regardless of whether this was for internal or external sales.

The PTA points out that no position is taken on whether Mila is breaching the principle of non-discrimination by providing access or not in this cost analysis. This must be dealt with separately in another case than in the one here under discussion.

The PTA has examined the Mila corrections and calculations as presented in the company's response here above along with other minor corrections and it is the conclusion of the Administration that the tariff needs to be corrected such that the price for a standard lease unit in Halls will be reduced from ISK 17,201 to ISK 17,004, in Rural Areas from ISK 22,884 to 22,785 and in Uninhabited from ISK 39.788 to 39.671. Other lease units within these categories will be reduced correspondingly.

ASI refers to salary agreements that were made last 21 December. One of the main criteria for the salary agreements is low inflation which will ensure stability and increased purchasing power. This emphasis was supported by the parties to the agreement and the government has endorsed its importance.

In the salary agreements in question, employers and employees agreed on measures to support the objective of increased purchasing power, lower inflation and a reduction of expectations for inflation in the economy. Among these measures was that companies and government exercised utmost restraint in their price decisions. For this to be successful, companies at all levels in the economy, the State and municipalities had to shoulder responsibility and demonstrate solidarity by reining in price increases.

The increase that the Post and Telecom Administration has now agreed for the Mila ehf. tariff for leasing of facilities will eventually result in higher prices to consumers on the electronic communications market and will contribute to an increase in the consumer price index. The Minister for Finance and the Economy recently wrote a letter to the boards of state undertakings where the unequivocal message was directed at all companies owned by the state to do their utmost to restrict increases in tariffs and that price increases that had already been decided should be reviewed in the light of the salaries agreements' objectives of lower inflation and increased purchasing power. In this way the Minister was supporting the position of ASI which had encouraged companies and public bodies to support workers and to support the objectives of the salaries agreement by not increasing prices for their goods and

services. In the light of the above it was out of line that a public regulatory body should at the same time authorise a party with exclusive selling rights to increase its tariff by up to 9%.

ASI challenges the Administration to review its planned Decision.

The position of the PTA

As has previously been stated, the existing Mila wholesale hosting tariff is based on a cost base from the year 2009 and the tariff has been unchanged since 2010. The increase is based on the increase in Mila costs incurred in providing this service and is significantly lower than the increase in the building price index for this period. The tariff increase is about 8.2% while the increase in the building price index is 18% for the same period. The PTA has in the past years not accepted proposals from Mila for increases in tariff on the basis of increases in price indexes.

With the PTA Decision no. 26/2007 on the market for local loops and 20/2007 for leased lines etc., obligations were imposed on Mila for access to facilities and for wholesale price control. Price for access was to be based on historical costs with the addition of reasonable profit. This means that the cost analysis being treated in this instance is based on Mila costs for the provision of the service in question.

In connection with the work on the prior Mila cost analysis from 2010 a revaluation was made on buildings, support systems and facilities. The cost analysis under discussion here is based on this re-evaluation which is in accordance with Regulation no. 564/2011 on accounting and cost analysis in the operations of electronic communications companies. In the light of this fact the PTA considers that investment costs on which the conclusion is based with respect to price for hosting which was published in the consultation document give a realistic picture of replacement cost of the hosting locations that are used for lease of facilities. The above acts as restraint on Mila as the company may not base its conclusions solely on its the company's costs when deciding prices. When reviewing Mila's cost, the PTA considers the development of total costs of this operation at Mila in comparison with the development of prices in general. PTA may reject costs that the Administration believes to stem from inefficient operations.

In the proposed decision, PTA shall take into account the Act on the Post and Telecom Administration, the Electronic Communications Act and applicable regulations. PTA is not authorised to ignore the results of Mila's cost analysis and determine the same fee for the rental of facilities in buildings and mast on the basis of goals of a salary agreements, of low inflation and increased purchasing power.