



## EUROPEAN COMMISSION

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Ryšių reguliavimo tarnyba (RRT)  
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Lithuania

For the attention of:  
Mr. Feliksas Dobrovolskis  
Director

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Dear Mr Dobrovolskis,

**Subject: Commission Decision concerning Case LT/2015/1731: Wholesale call termination on individual public telephone networks provided at a fixed location in Lithuania**

**Opening of Phase II investigation pursuant to Article 7(4)(a) and 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC**

### 1. PROCEDURE

On 24 April 2014, the Commission registered a notification from the Lithuanian national regulatory authority, Ryšių reguliavimo tarnyba (RRT)<sup>1</sup>, concerning the wholesale markets for call termination on individual public telephone networks provided at a fixed location<sup>2</sup> in Lithuania.

The national consultation<sup>3</sup> ran from 27 February to 20 March 2015.

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<sup>1</sup> Under Article 7 of 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 L 108, 24.4.2002, p. 33, as amended by Directive 2009/140/EC, OJ L 337, 18.12.2009, p. 37, and Regulation (EC) No 544/2009, OJ L 167, 29.6.2009, p. 12.

<sup>2</sup> Corresponding to Market 1 in Commission Recommendation 2014/710/EU of 9 October 2014 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 communications networks and services (Recommendation on Relevant Markets), OJ L 295, 11.10.2014, p. 79.

<sup>3</sup> In accordance with Article 6 of the Framework Directive.

On 4 May 2015, a request for information<sup>4</sup> was sent to RRT and a response was received on 7 May 2015. Further information was provided during a conference call on 8 May 2015.

Pursuant to Article 7(4) of the Framework Directive, the Commission may notify the national regulatory authority (NRA) and the Body of European Regulators for Electronic Communications (BEREC) of its reasons that the draft measure would create a barrier to the internal market or its serious doubts as to its compatibility with EU law.

## **2. DESCRIPTION OF THE DRAFT MEASURE**

### **2.1. Background**

The market for call termination on individual public telephone networks provided at a fixed location in Lithuania was previously notified to and assessed by the Commission under case LT/2014/1622<sup>5</sup>. RRT found ten operators to hold SMP on their respective termination markets and imposed on the incumbent - TEO LT - access, non-discrimination, transparency, price control and cost accounting obligations, while the alternative network operators (ANOs) were subject to access and price regulation only. RRT proposed not to set Fixed Termination Rates (FTRs) on the basis of a pure BU-LRIC model, as set out in the Commission's Termination Rates Recommendation<sup>6</sup>, but to calculate them on the basis of the historic ratio between the Mobile Termination Rates (MTRs) and the FTRs. This approach resulted in FTR price caps of 0.61 €cents/min, which was the same FTR which was being applied at the time of the notification. The Commission opened a Phase II investigation on the basis that the methodology adopted by RRT to set FTRs did not allow the fulfilment of the objectives pursued by the regulatory framework and would lead to the creation of barriers to the internal market and higher prices for consumers. Following the opening of the Phase II investigation, RRT withdrew its notification.

### **2.2. Market definition**

RRT defines the fixed call termination market as *"the transmission of a call from the fixed network exchange (including the exchange) (...) to the point of the same fixed network or to the point of other fixed networks, where the call is terminated and the network point is identified by a particular telephone number"*. The definition is broadened compared to the 2014 analysis, as it now includes a particular type of service where the person receiving the call is not a subscriber of the network operator terminating the call, but of a service provider (SP) who operates the termination point to end-users but does not dispose of (or doesn't use) a switching equipment and/or has not been attributed a number by the Authority (or does not use it). This would be the case for some operators offering managed VoIP services, for example. These operators need to rely on the network of another operator to provide call termination services (via wholesale agreements). RRT

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<sup>4</sup> In accordance with Article 5(2) of the Framework Directive.

<sup>5</sup> C(2014) 5103

<sup>6</sup> Commission Recommendation of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, OJ L124, p. 67 (the "Termination Rates Recommendation").

believes that this type of call termination service should be included in the market definition, although it explains that the volume generated by this type of agreements is a small percentage of the total.

The market for call termination on individual public telephone networks provided at a fixed location defined by RRT includes the termination of all types of calls irrespective of where the call originates (nationally, internationally, from fixed or mobile numbers) when provided on fixed PSTN and VoIP networks<sup>7</sup>.

Calls terminated to non-geographic telephone numbers, such as those used to provide value-added services, continue to be included in the market<sup>8</sup> because some non-geographical numbers that could be used to provide value-added services are in practice used to provide traditional call services. Therefore, in order to avoid performing an individual analysis on every telephone number which could potentially be used to provide value-added services, the regulator decided to define a product market that includes calls to all telephone numbers of this type, regardless of the actual way they are being used. RRT notes that these services are generally provided as a bundle of call termination services and content services.

As regards to non-geographic numbers, RRT acknowledges that the Commission's explanatory memorandum of the 2014 Recommendation on relevant markets suggests that these should not be included in the definition of the call termination market. However, RRT argues that call termination on non-geographic numbers was included in the scope of the market for call termination on individual mobile networks (Market 2). By including non-geographic numbers also in the market definition for fixed termination services, RRT believes that equal competitive conditions will be created between fixed and mobile network operators.

RRT defines nine individual markets corresponding to the networks of the following operators: TEO LT, Lietuvos geležinkeliai, Lietuvos radijo ir televizijos centras, CSC TELECOM, LINKOTELUS, MEDIAFON, Nacionalinis telekomunikacijų tinklas, Telekomunikacijų grupė, and ECOFON.

The geographic scope of these markets is national.

### **2.3. Finding of significant market power**

On the basis of its market analysis, RRT intends to designate the 9 above-mentioned network operators as having SMP in their respective markets for fixed call termination.

The main criteria considered by RRT when reaching its conclusions on SMP include: i) market shares (each operator has 100% share on the relevant market), ii) barriers to entry, iii) absence of potential competition, and iv) absence of

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<sup>7</sup> The market includes call termination services related to telephone numbers from the number series 1XX(XXX), 3XXXXXXX, 4XXXXXXX, 5XXXXXXX, 7XXXXXXX, 8XXXXXXX, 9XXXXXXX.

<sup>8</sup> Indeed, RRT explained that value-added services had been included in the 2014 market definition, although this had not been explicitly included in their notification. The non-geographic number series included in the market are as follows: 1XX(XXX) (short numbers), 7XXXXXXX (personal numbers), 8XXXXXXX (free-of-charge numbers) and 9XXXXXXX (value-added services).

countervailing buying power.

## **2.4. Regulatory remedies**

As regards TEO LT, RRT proposes to maintain the access and transparency obligations and to withdraw the accounting separation obligation, considered to be excessively burdensome for the incumbent. Moreover, the regulator proposes to amend the non-discrimination and price control obligations in the following way:

- Non-discrimination obligation: under the new proposed remedies, TEO LT would no longer be required to apply the same termination rates to calls originated within and outside the European Economic Area (EEA). TEO LT, however, would continue to be required to charge the same termination rate to all calls originated within the EEA (see price control obligation below). It would also be required to charge symmetric termination rates to non-EEA operators that are buying the same call termination services (i.e. to different operators in a same country).
- Price control obligation: RRT proposes to set the FTR for calls originated within the EEA at 0.26 € cents/min. (excl. VAT). TEO LT will be free to set any rate that it considers appropriate for the termination of calls originated outside of the EEA (while complying with the non-discrimination obligation mentioned above).

As regards the other eight SMP operators, RRT proposes to maintain the access obligation and to amend the price control obligation by requesting them to charge FTRs that are not higher than the FTRs applied by TEO LT<sup>9</sup>. As in the case of the incumbent, the regulation of prices of call termination services for ANOs is limited to calls originated within the EEA. The non-discrimination and the transparency obligations are not imposed on the ANOs.

RRT explains that the price cap of 0.26 €cents/min was calculated using a BU-LRAIC model, which was developed by the RRT in 2015. The net BU-LRAIC costs were calculated by RRT on the basis of a NGN single-layer (national) IP core network, modelled upon TEO's current network and services. RRT did not perform any significant adjustment of TEO's data (on dimensioning of access lines, demand, prices of equipment, etc.) in order to adjust for the historical operator's inefficiencies, because it believes that the BU-LRAIC model itself is sufficient to eliminate network inefficiencies. The access network was not modelled, but it was assumed that the various access technologies are aggregated by multi-service access node (MSANs).

The RRT runs the model to determine the cost of call termination over a period of 10 years, using actual data (from 2010 to 2013) and RRT's own forecasted demand (from 2014 to 2020) for call termination provided. The data shows a constant increase in the volume of terminated calls up to 2020. The year-by-year results of the BU-LRAIC model change significantly, ranging from a FTR of 0.1844 €cents/minute in 2010 to 0.037 €cents/minute based on the volume assumptions for 2020. RRT's sensitivity analysis, during which the demand for call termination services was changed while keeping other parameters constant, showed that the cost calculation results were very sensitive to the fluctuation of demand for call

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<sup>9</sup> RRT explains that such a price control remedy would in practice reduce the number of administrative procedures when a change to the regulated rates will occur, given that all the alternative operators' FTRs would be changed by amending only the incumbent's FTR.

termination services. RRT decided to choose the model's maximum output value over the 10-year period (0.1844 €cents/minute), which refers to the year 2010.

On top of the cost generated within the model, RRT proposes to add costs related to network support and maintenance (revenue management, payment administration, administration of services sold and others), which "are not properly assessed under the BU-LRAIC model"<sup>10</sup>. The wholesale commercial costs were derived from TEO's regulatory accounting data and amount to 0.0782 €cents/minute - which if added to the BU-LRAIC cost output (0.1844 €cents/minute) give the final value of the price cap to be applied (0.26 €cents/minute ex. VAT).

The entry into force of the new measures is foreseen for 1 September 2015, allowing a three-month transitional period so that operators can adjust to the new regulation. The new measures would be valid at least until the next market analysis, which is expected in 2018. RRT believes that operators will continue to apply the interim rate of 0.61 €cents/min (which entered into effect on 1<sup>st</sup> January 2013 and was supposed to be replaced as of October 2013) until the new rates are implemented.

### **3. ASSESSMENT**

Following the examination of the notification and the additional information provided by RRT, the Commission considers that the draft measures concerning wholesale call termination on individual public telephone networks provided at a fixed location in Lithuania (market 1 of the Recommendation) fall within the scope of Article 7(4)(a) and 7(a) of the Framework Directive and would affect trade between Member States.

#### **A. Serious doubts pursuant to Article 7(4)(a) of the Framework Directive as regards the market definition**

RRT's draft measures concerning wholesale call termination on individual public telephone networks provided at a fixed location in Lithuania fall within Article 7(4)(a) of the Framework Directive because the relevant product market is defined differently from market 1 such as envisaged in the Commission's Recommendation on Relevant Markets. First, RRT's proposed market definition seems to imply the inclusion of some transit services in the relevant termination markets. Second, termination of calls to non-geographic numbers is included in the market without a proper analysis justifying such inclusion.

Thus, at the current stage of the procedure and on the basis of the information available, the Commission has serious doubts that RRT's proposed product market definition is compatible with EU law, and particularly with the obligation stipulated in Article 15(3) of the Framework Directive that NRAs shall, taking utmost account

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<sup>10</sup> In order to assess the amount of such costs, the RRT concluded an analysis of costs of call termination services incurred by TEO LT from 2010 to 2013 and calculated on the basis of cost accounting according to the rules on the method of Fully Distributed Costs. Having eliminated from the calculated costs of TEO LT the depreciation of fixed assets, return on investment, total costs, number maintenance costs, and having divided the number obtained from the amount of services provided (the duration of calls terminated on the TEO Network), the specific costs related to provision of call termination of services were estimated.

of the Recommendation and the SMP Guidelines<sup>11</sup>, define relevant markets in accordance with the principles of competition law.

The Commission, therefore, expresses serious doubts as to the compatibility of RRT's proposed market definition with EU law for the following main reasons:

**Lack of clear delineation between the transit market and the relevant termination markets**

As stated in the SMP Guidelines, the relevant product/service market comprises all those products or services that are sufficiently interchangeable or substitutable, not only in terms of their objective characteristics, by virtue of which they are particularly suitable for satisfying the constant needs of consumers, their prices or their intended use, but also in terms of the conditions of competition and/or the structure of supply and demand on the market in question.

RRT defines the relevant product market as the *"transmission of a call from the fixed network exchange (including the exchange) where the network interconnection is possible to the point of the same fixed network or to the point of other fixed networks, where the call is terminated and the network point is identified by a particular telephone number"*.

First, the Commission considers that the product definition proposed by RRT does not allow to clearly identify the boundaries of the market. In particular, the current draft leaves some ambiguities as to whether the proposed termination market includes also a transit element. In the response to the RFI and in the conference call held on 8 May 2015, RRT explained that the above market definition aims to capture a particular type of termination service where the person receiving the call is not a subscriber of the network operator terminating the call but of a service provider (SP) who would operate the termination point to end-users but would not dispose of (or not use) a switching equipment and/or would not have been attributed a number by the Authority (or would not use it). It is unclear to the Commission why the conveyance of a call from the network operator's switch to the SP's termination point should be considered as a termination service (rather than a transit service) if the SP (with whom the end-user has a contract) owns a termination point and has been attributed a telephone number.

Therefore, the Commission has serious doubts whether the broader (as compared to the current) definition of the termination service as proposed by RRT in the notified draft measure does not lead to a potential regulation of transit services, whereas only the termination bottleneck should be included in the relevant market. If transit services, which the Recommendation on Relevant Markets does not identify as a market susceptible to *ex ante* regulation, were to be actually included in the market, RRT should have carried out a thorough substitutability analysis in line with the SMP Guidelines. The Commission therefore, based on the evidence provided so far, has serious doubts that RRT's market delineation

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<sup>11</sup> Commission Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications and services (2002/C 165/03), ("the SMP Guidelines").

has been done in accordance with the principles of competition law and is compliant with Article 15(3) of the Framework Directive.

**Lack of sufficient evidence that the termination of calls to all types of non-geographic numbers should be included in the relevant termination markets**

In the notified draft measure RRT explicitly considers the Commission's view expressed in the Explanatory note to the Relevant Markets Recommendation that the termination of calls to non-geographic numbers used by service providers is usually characterised by market and competitive conditions that are different from those prevailing in the context of voice call termination to other end-users<sup>12</sup>. RRT concludes, however, that the relevant termination market includes the termination of calls to all types of fixed non-geographical numbers i.e. to short numbers, to personal and free-of-charge numbers, as well as to numbers for value-added services.

While acknowledging that given the variety of non-geographic numbers and of contractual agreements among operators, the termination of calls to some non-geographic numbers might be indeed part of the relevant termination market in some Member States, the Commission notes that RRT has not analysed in depth the characteristics and, above all, the competitive conditions defining the provision of termination to the different non-geographical numbers used in Lithuania.

The Commission refers to the Explanatory note to the Relevant Markets Recommendation according to which the mechanics of the termination of calls to non-geographic numbers for the provision of value added services would rather argue in favour of excluding this type of termination from the relevant market.

RRT explains that the termination of calls to some non-geographical numbers that could be used to provide value-added services (short numbers (1xxx), personal numbers (7xxx)) are in practice used to provide traditional call services and that in order to avoid performing an individual analysis on every telephone number which could potentially be used to provide value-added services, the regulator decided to define a product market that includes calls to all telephone numbers of this type, regardless of the actual way they are being used.

The Commission considers that RRT has not sufficiently assessed whether the market and competitive conditions characterising the provision of termination

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<sup>12</sup> The Commission's Explanatory Note to the Recommendation on Relevant Markets specifies that in the case of call termination services to non-geographic numbers used by service providers (e.g. for the purposes of providing premium rate services), operators do not seem to be indifferent to the termination charge paid by the calling party as this affects their competitive advantage, as long as they themselves operate in downstream markets that are characterised by competition in the services that they provide. As the choice of terminating operator and the resulting price affect the revenues of the called service providers, the party being called is both aware of and sensitive to the price of termination. In that respect, these services differ from traditional voice call termination services interconnecting two end-users. Therefore, in the case of calls to non-geographic numbers operated by service providers, the service provider may purchase termination from any network operator and is able to switch network operators with a view to increase its profit and/or to reduce its costs. As a consequence, the terminating operator is generally facing a competitive constraint, being presented with a risk that its service provider end customer can switch to another network operator in case of an increase of termination rates, causing a loss of revenue, unless there are objective and insurmountable obstacles to switching terminating operator.

services to different non-geographic numbers are similar to those of providing voice call termination to a geographic number.

RRT has insufficiently assessed the characteristics of termination of calls to the different categories of non-geographic numbers such as their functionalities, network coverage requirements or prices. The Commission is of the view that RRT has not sufficiently reflected in its assessment on the potential demand and supply substitutability between these services and the traditional termination service. In light of the above, the Commission takes the view that RRT has not sufficiently demonstrated that the termination of calls to non-geographic numbers is part of the relevant market.

The Commission therefore raises serious doubts that RRT's proposed product market definition complies with Article 15(3) of the Framework Directive according to which national regulatory authorities identify markets in their territory, taking utmost account of the Recommendation on Relevant Markets and the Guidelines, in accordance with the principles of competition law.

#### **B. Serious doubts pursuant to Article 7 (a) of the Framework Directive as regards the imposition of appropriate remedies**

Moreover, following the examination of the notification and the additional information provided by RRT, the Commission considers that the notified draft measures fall under the Commission's powers of ensuring the consistent application of remedies as set out in Article 7(a) of the Framework Directive. RRT's draft measures are in application of Article 16 of the Framework Directive and aim at the imposition of obligations set out in Articles 9-13 of the Access Directive.

The Commission has serious doubts as to the compatibility of RRT's draft measures with EU law and considers that they would create a barrier to the internal market. The Commission expresses its serious doubts as follows:

*a) The need to ensure that customers derive maximum benefits in terms of efficient cost-based termination rates*

*Compliance with Articles 8(4) and 13(2) of the Access Directive in conjunction with Article 8 of the Framework Directive and Article 16(4) of the Framework Directive*

The Commission refers to Articles 8(4) and 13(2) of the Access Directive<sup>13</sup>, which require NRAs (i) to impose remedies, which are based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of the Framework Directive and (ii) in relation to the imposition of price controls to ensure that the chosen cost recovery mechanism serves to promote efficiency and sustainable competition and maximises consumer benefits. Moreover, the Commission refers to Article 16(4) of the Framework Directive, which requires NRAs to impose on SMP undertakings appropriate regulatory obligations.

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<sup>13</sup> Directive 2002/19/EC of the European parliament and the Council of 7 March 2002 on access to, and interconnection, of electronic communications networks and associated facilities, OJ L 108, 24.4.2002, p. 7 (the Access Directive).



In addition, the Commission would like to stress that pursuant to Article 8(3) of the Framework Directive NRAs shall contribute to the development of the internal market by cooperating with each other, with the Commission and BEREC in a transparent manner to ensure not only the development of a consistent regulatory practice but also consistent application of the Framework Directive and the Specific Directives (together, the Regulatory Framework).

In the context of the wholesale markets for fixed voice call termination, the Commission underlines that, given its characteristics and the associated competitive and distributional concerns<sup>14</sup>, the above mentioned objectives of promoting efficiency and sustainable competition, maximising consumer benefit and contributing to the development of the internal market, would best be achieved by a cost orientation remedy based on a pure BU-LRIC methodology.

In this regard, the Commission may issue recommendations<sup>15</sup> on the harmonised application of the Regulatory Framework in order to further the achievement of the objectives set out in Article 8 of the Framework Directive. This right arises in particular where the Commission finds that divergences in the implementation by the national regulatory authorities of their regulatory tasks under the Regulatory Framework may create a barrier to the internal market. It is in this context that the Commission, in order to ensure a correct and coherent interpretation and application of the relevant provisions of the Regulatory Framework within the EU, adopted a Recommendation on fixed and mobile termination rates in the EU (the "Termination Rates Recommendation"), setting out a consistent approach that the NRAs should in principle follow regarding price control obligations for fixed and mobile termination rates.

The Commission recommended to NRAs to ensure that termination rates are implemented at a cost efficient, symmetric level as of 31 December 2012. As stated above, in the context of termination markets and for the reasons set out above, a cost efficient rate is normally the one resulting from a pure BU-LRIC methodology.

Moreover, any regulatory approach chosen by the NRA alternative to the one recommended by the Commission according to Article 19 of the Framework Directive has to comply with the other provisions of this Directive and the Specific Directives, in the present case, in particular Articles 8(4) and 13(2) of the Access Directive in conjunction with Article 8 and Article 16(4) of the Framework Directive.

The Commission takes the view that a cost orientation remedy based on a pure BU-LRIC methodology best promotes competition by, among other things,

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<sup>14</sup> The accompanying Explanatory Note of the Commission Staff Working paper (SEC(2009) 600, 7.5.2009) sets out that due to the particular nature of the termination markets characterised on the one hand by "two-way" interconnection and on the other hand by monopolies in each relevant market, which create the incentives of terminating operators to raise prices substantially above cost, cost-orientation obligations based on a BU-LRIC methodology are the most appropriate intervention to address productive- and allocative-efficiency concerns as well as maximising consumer welfare. As a result, in order to ensure compliance with the requirements of the regulatory framework, in particular Article 13(2) of the Access Directive, i.e. the requirements to promote efficiency and sustainable competition as well as to maximise consumer benefits, NRAs shall apply a BU-LRIC cost model when setting termination rates.

<sup>15</sup> In accordance with Article 19 of the Framework Directive.

ensuring that all users derive maximum benefit in terms of choice, price and quality, in line with Article 8(2) of the Framework Directive. Moreover, the Commission observes that fixed termination rates, which are based on a pure BU-LRIC model, contribute to a level playing field among operators, by eliminating competitive distortions in the termination markets.

The Commission has serious doubts as to the appropriateness of RRT's proposed costing methodology to comply with the above principles, thus fulfilling the objectives set out in the Regulatory Framework.

RRT proposes to set the price caps for FTRs in Lithuania at 0.26 €cents/min. This level corresponds to the sum of the result of a costing model (0.1844 €/min) and a mark-up for wholesale commercial costs (0.0782 €cents/min).

The cost model used when calculating the above price caps is considered by RRT to be in line with the recommended pure BU-LRIC model. RRT's proposed approach results in price caps which are almost three times as high as the average of the rates in those Member States which apply the recommended methodology<sup>16</sup>. At the same time, the Commission could not identify any national specificities (e.g. network topology) which would drive up the costs of providing termination service in Lithuania in such a significant manner.

The Commission notes instead that while RRT models a period of ten years (from 2010 to 2020), it uses the model's highest cost output<sup>17</sup> for the purpose of setting the price cap (i.e. the cost of 0.1844 eurocents/min), which corresponds to the lowest underlying demand for termination services in the year 2010.

RRT states itself in the response to the RFI that their decision to use the highest cost output is perhaps one of the main reasons of obtaining the relatively high price cap of 0.26 €cents/min.

The Commission notes that while RRT's global market analysis is carried out in a forward-looking perspective<sup>18</sup>, the NRA's decision to consider the cost assumption corresponding to the demand level of almost 5 years ago does not reflect a forward-looking approach. RRT explains that, despite the increase in demand and decrease of costs over the modelled period, it fears a sudden increase in costs if the forecasted demand volumes are far from the actual future demand. As there is no further explanation in the draft measure why such development against the predicted trend should occur, the Commission considers RRT's explanation not sufficiently substantiated and RRT's choice of the highest cost output as arbitrary.

Furthermore, the Commission notes that instead of modelling a hypothetical efficient operator, RRT's model uses the incumbent's (TEO's) network and services, which RRT considers to be efficient. RRT clarified in the conference call of 8 May that data presented by TEO was assessed as not being artificially

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<sup>16</sup> The current average amounts to 0.0995 €cents/min.

<sup>17</sup> RRT explains that the cost output corresponding to demand in 2020 is 0.0370 €cents

<sup>18</sup> In line with *inter alia* Recital 20 of the SMP Guidelines and recital 9 of the Recommendation on Relevant Markets.

inflated. The Commission notes that the wholesale commercial costs (0.0782 eurocents/min) are derived from TEO's data which has not been adjusted for efficiency, as confirmed by RRT in the conference call.

The Commission acknowledges that according to the Termination Rates Recommendation, the results of a BU-LRIC model may be reconciled with a top-down approach, to assist the NRA in the verification of the bottom-up (BU) modelling. Such reconciliation exercise should start with producing BU data which can only then be checked against the incumbent's actual data. This is important since top-down models based on actually incurred costs do not give incentives to innovate in the provision of services, which are the main rationale behind BU models. The Commission further considers that wholesale commercial costs should be derived from the costing model itself, rather than being calculated outside the model and added to the model's cost result, as RRT's proposed approach suggests. In the absence of a BU-LRIC evaluation of wholesale commercial costs, it is difficult to assess to what extent figures provided by the incumbent reflect efficient operational costs. The Commission is therefore of the view that RRT has failed, at this stage, to demonstrate that the price caps proposed are based on efficient costs.

Moreover, when adopting the Termination Rates Recommendation, the Commission clearly stated that, when deciding on the correct level of the regulated wholesale termination rate, it is essential to ensure that the methodology chosen pursuant to Article 13(2) of the Access Directive promotes efficient production and consumption decisions and minimises artificial transfers and distortions between competitors and consumers<sup>19</sup>. Due to the specific (two-sided) nature of call termination only a narrow definition of the incremental cost will lead to the most efficient and least distortionary use of call termination services and ultimately minimise the risk of problems such as cross-subsidisation between operators and inefficient pricing and investment behaviour.

In light of the shortcomings identified above, the Commission questions the reliability of RRT's proposed methodology to set the right cost signal for the provision of the relevant wholesale termination service, since it does not guarantee that TEO's costs would be actually incurred by an efficient operator. Such approach does not appear to encourage the regulated operators to minimise their production costs and to increase their productive efficiency over time. By allowing the recovery of inefficiently incurred costs, through higher price caps on fixed termination rates, RRT's proposed regulation could ultimately lead to higher retail prices. Such regulatory approach hence does not appear to be in line with Article 13(2) of the Access Directive which stipulates that NRAs shall ensure that any pricing methodology should serve to promote efficiency, sustainable competition and maximise consumer benefit.

In conclusion, the Commission considers, that RRT's proposed costing methodology would not allow achieving the regulatory objectives set out in Article 8 of the Framework Directive, as it may lead to competitive distortions between operators with asymmetric market shares and traffic flows and,

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<sup>19</sup> See for more detail, in particular, section 4.1 of the Commission Staff Working Document accompanying the Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU of 7 May 2009, SEC(2009) 600.

ultimately, lead to the application of higher consumer tariffs, as they will be based on wholesale products priced above efficiently incurred cost.

The Commission therefore expresses its serious doubts as to the compatibility of the proposed draft measures with Articles 8(4) and 13(2) of the Access Directive in conjunction with Articles 8 and 16(4) of the Framework Directive.

*b) Creation of barriers to the internal market*

The approach proposed by RRT results in fixed termination rates which are not BU-LRIC based, thus exceeding the efficient cost of providing the relevant termination service. This asymmetry in setting FTRs in Lithuania implies unjustified cost differences to be incurred at the expense of the operators, and ultimately consumers, in the Member States from where the calls originate.

The Termination Rates Recommendation has been adopted for the purpose of avoiding such cross-subsidisation among Member States, thus contributing to the development of the internal market and to the fulfilment of the objectives set out in Article 8 of the Framework Directive. A consistent approach in setting fixed termination rates is particularly important to ensure that regulators set tariffs at an efficient cost level thus preventing asymmetries within the EU which have a significant detrimental effect on the development of the internal market, and, therefore, result in a violation of the principles and objectives of Article 8(2) and (3) of the Framework Directive. In light of the above considerations, the Commission takes the view, at this stage, that the draft measure would create barriers to the internal market.

*c) Conclusion*

The Commission observes that RRT does not provide a sufficient justification why its proposed approach for the calculation of fixed termination rates in Lithuania meets the policy objectives and regulatory principles enshrined in Article 8 of the Framework Directive, and can be considered to be in line with Article 8(4) of the Access Directive. Hence, the Commission has serious doubts that the methodology proposed by RRT concerning the calculation of fixed termination rates can be considered appropriate in the given termination markets within the meaning of Article 16(4) of the Framework Directive and justified in light of the objectives laid down in Article 8 of the Framework Directive, and in particular the objectives of promoting competition and user benefits pursuant to Article 8(2) of the Framework Directive and believes, at this stage, that the draft measure would create barriers to the internal market.

The above assessment reflects the Commission's preliminary position on this particular notification, and is without prejudice to any position it may take vis-à-vis other notified draft measures.

The Commission points out that, in accordance with Article 7 of the Framework Directive, the draft measures with respect to the definition of the markets for wholesale voice call termination on individual public telephone networks at a fixed location in Lithuania shall not be adopted for further two months.

Moreover, in accordance with Article 7(a) of the Framework Directive, the draft measures regarding the regulatory obligations on the markets for wholesale voice call termination on individual public telephone networks at a fixed location in Lithuania shall not be adopted for further three months.

Pursuant to Recital 17 of Recommendation 2008/850/EC<sup>20</sup>, the Commission will publish this document on its website, together with a notice inviting third parties to submit observations on this serious doubts letter within five working days with respect to the market definition, and within ten working days with respect to the regulatory remedies. The Commission does not consider the information contained herein to be confidential. You are invited to inform the Commission<sup>21</sup> within three working days following receipt whether you consider that, in accordance with European Union and national rules on business confidentiality, this document contains confidential information which you wish to have deleted prior to such publication. You should give reasons for such request.

Yours sincerely,

For the Commission  
Christos Stylianides  
Member of the Commission

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<sup>20</sup> Commission Recommendation 2008/850/EC of 15 October 2008 on notifications, time limits and consultations provided for in Article 7 of Directive 2002/21/EC, OJ L 301, 12.11.2008, p. 23.

<sup>21</sup> Your request should be sent either by email: CNECT-ARTICLE7@ec.europa.eu or by fax: +32.2.298.87.82.