COMISIÓN DEL MERCADO DE LAS TELECOMUNICACIONES

IGNACIO REDONDO ANDREU, Board Secretary of the *Comisión del Mercado de las Telecomunicaciones* (Telecommunications Market Commission*, CMT*), by means of those capacities bestowed on him by article 40 of that Commission's Regulations, approved by Spanish Royal Decree 1994/1996, of 6 September

HEREBY CERTIFIES:

That Board Meeting No. 24/09 of the Comisión del Mercado de las Telecomunicaciones held on 2 July 2009, did adopt the following

AGREEMENT

By this, in file no. MTZ 2009/1945 we hereby approve the following

RESOLUTION APPROVING THE DEFINITION AND ANALYSIS OF THE TRUNK SEGMENTS OF THE WHOLESALE RENTED LINES, THE DESIGNATION OF AN OPERATOR WITH SIGNIFICANT MARKET POWER AND THE ENFORCEMENT OF SPECIFIC OBLIGATIONS, AND THE AGREEMENT TO NOTIFY THE EUROPEAN COMMISSION OF THE SAME.

FACTUAL BACKGROUND

First. Initiation of Procedure

On 15 January 2009 the process of market definition and analysis of the trunk segments of the wholesale rented lines was initiated, so as to designate an operator with significant market power and to enforce specific obligations, as well as to open the procedure for public inquiry and the request for report from the Spanish Competition Commission (hereinafter, CNC).

Notification of the cited act was published in the Spanish Official Journal number 23 dated 27 January 2009.

Second. Report by the Spanish Competition Commission

The report drawn up by the CNC with regards the definition of the wholesale trunk segment markets of rented lines has been sent to the Comisión del Mercado de las Telecomunicaciones (CMT).

Third. Allegations in the public inquiry

The following operators presented allegations in the public inquiry: Cableuropa, S.A.U and Tenaria, S.A. (ONO), France Telecom España, S.A. Vodafone España, S.A.U. and Telefónica de España, S.A.U.
The Secretariat of Telecommunications and the Information Society of the Catalonian Government (Secretaria de Telecomunicacions i Societat de la Informació de la Generalitat de Catalunya) and the Directorate General for Technology and Communications and the Communications Government of the Balearic Islands also put forward their observations to the public inquiry.

Fourth. Extension of the procedure deadline

Due to the complexity of the current procedure, on the 23 February 2009, in accordance with article 42.6 of Law 30/1992 dated 26 November 2006, of the Legal Framework of Public Administration and Common Administrative Procedures (herein referred to as LRJPAC), the Secretary of the CMT agreed in writing the extension of the maximum resolution period and notification of same by a further three months.

This extension was published in the Spanish Official Journal number 53 dated 3 March 2009.

Fifth. Notice of the Draft Measure

On 14 of May 2009 written agreement was given of the notification of the Draft Measure relating to the market definition of the trunk segments of wholesale rented lines, to designate an operator with significant market power and to enforce specific obligations, so that the Spanish Ministry of Industry, Tourism and Commerce, the Spanish Ministry of Economy and the Treasury, the European Commission and the National Regulatory Authorities of the EU member states could present their findings in the maximum time frame of one month.

The European Commission was informed of the Draft Measure on the 15 May 2009.

Sixth. Remarks by the European Commission

On 16 June 2009, the European Commission written documentation was entered into the CMT's Register which contained observations of the notified Draft Measure.

Seventh. Comments by the Spanish Ministry of Economy and the Treasury

On 23 June 2009 written documentation from the Directorate General of Economic Policy from the Spanish Ministry of Economy and the Treasury was entered into this Commission's Register, which contained observations on the Draft Measure.

LEGAL BASIS

Fisrt. Authorisation for Competition

The General Telecommunications Law 32/2003 of 3 November (hereinafter LGTel) in articles 10, 48.2, and 48.3.g) recognises that the Comisión del Mercado de las Telecomunicaciones has the capacity to: (i) define and analyse the reference markets, (ii) determine which operators have significant market power and (iii) impose, enforce, modify or suppress operators' specific obligations.

According to article 16.1 of EC Directive 2002/21 of 7 March 2002 regarding the common regulatory framework for networks and electronic communications services (hereinafter, Framework Directive), this procedure must be carried out as soon as possible following the Recommendation's adoption or modification, taking into account those Guidelines established by the European Commission. This provision became applicable in Spanish law by means of articles 10.2 and 3.1 of the LGTel and the Market Regulation respectively.

Therefore, Spanish Royal Decree 2296/2004 of 10 December, which approves regulations concerning the electronic communications markets, and access to the networks and numbering (hereinafter Market Regulations) develops, through articles 2 and 5, the procedure to be followed by the Comisión del Mercado de las Telecomunicaciones in order to identify and analyse the markets of reference for network operations and the supply of electronic communications services, and also describes its capacity to impose specific and appropriate obligations upon those operators that hold significant power within each market being examined.

This Commission will direct its actions according to that stated in the dispositions of the LRJPAC. That legal text regulates the practice of those public functions that are entrusted to this Commission by virtue of that stated in article 48 of the LGTel and article 2 of the Comisión del Mercado de las Telecomunicaciones Regulations.

Second. Regarding the procedure of defining the markets, analysing competition, identifying operators with significant market power, and imposing obligations on those principal operators within the market

On 17 December 2007, the European Commission adopted the Recommendation relating to the markets for electronic communications products and services that could be subject to *ex ante* regulation under the European Parliament and Council's Directive 2002/21/EC regarding a common regulatory framework for electronic communication services and networks (hereinafter, the Recommendation).

Whilst keeping in mind the declarations presented by operators in the public inquiry, and the Report by the National Competition Commission, the CMT developed a Draft Measure relating to this market.

According to article 7 of the Framework Directive and article 5 of the Market Regulation, the Draft Measure in question was reported to the European Commission, the Spanish Ministry of Industry, Tourism and Commerce, the Spanish Ministry of Economy and the Treasury, and to the National Regulatory Authorities from other European Union member states.

The European Commission lodged their observations of the Draft Measure which have been taken into consideration in the market definition and analysis of the trunk segments of the rented wholesale lines to designate an operator with significant market power and to enforce specific obligations, which is the aim of the current procedure.

Third. Market definition and analysis of the trunk segments of the rented wholesale lines to designate an operator with significant market power and to enforce specific obligations

I RETAIL SERVICES RELATED TO THE RENTED TRUNK LINES

The aim of this current market analysis procedure is set at the wholesale level.

In accordance with considerations (4) from the European Commission Market Recommendations,[1] "*the starting point for market definition in the current Recommendation is the wholesale market definition from a future perspective (...). Once the retail markets are defined the appropriate wholesale markets should then be defined".*

In the case of rented trunk lines, the demand for upstream services is a derived demand which depends, although indirectly, on existing retail demand.

In fact, operators contract rented trunk lines with the aim of completing their own trunk network. This network is sized in accordance to the needs generated by all the services supplied by the operator: broadband, telephone traffic, television, wholesale services to other operators, etc.

Therefore, strictly speaking, the services supplied by an operator generate capacity demand that can result, in certain routes, in the need to rent trunk lines from other operators.

Additionally, in Resolution dated 27 March 2008 regarding the conditions of underwater cable supply to the Canary Islands, it was concluded that the absence of competition in the trunk system negatively impacted on the level of competition in the retail markets on the Islands. Said Resolution used broadband as an indicator of the level of existing competition in the retail market as these services are the most dependent on the

[1]European Commission's Recommendation of 17 December 2007 relating to the markets for electronic communications products and services that could be subject to *ex ante* regulation under the European Parliament and Council's Directive 2002/21/EC regarding a common regulatory framework for electronic communication services and networks (hereinafter, Market Recommendation), DOUE L344/65 of 28 December 2007.

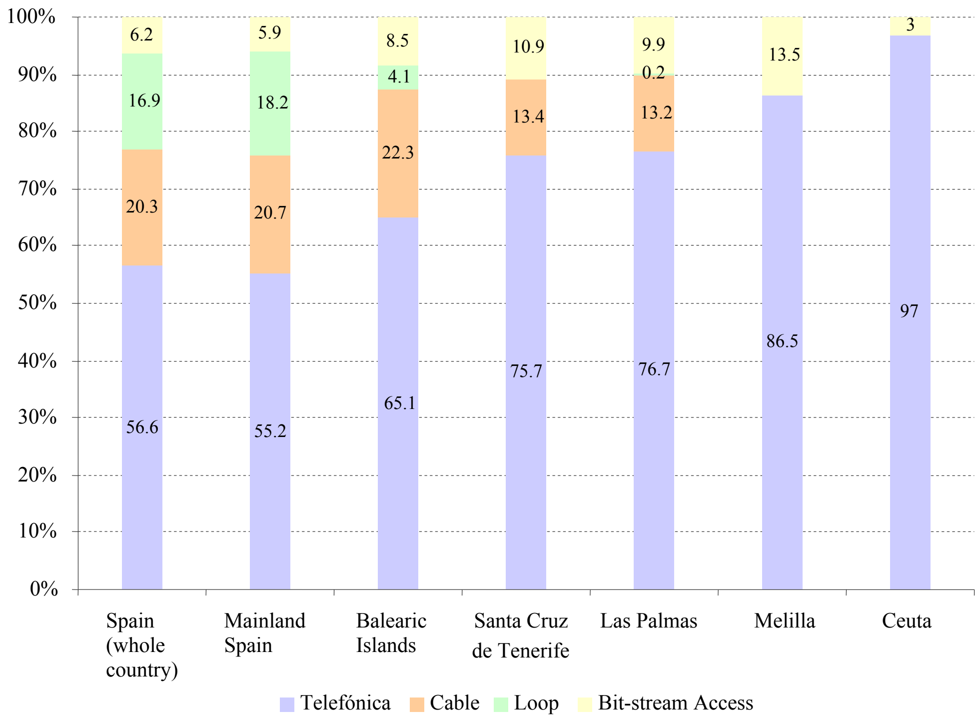
capacity of the underwater cable and as they allow for easy identification of the operators who supply services directly in the area (cable and loop unbundling).

The points above indicate that in certain circumstances difficulties encountered at the time of building a sufficient trunk network can impose a barrier to relevant entry to the supply of certain retail services.

On the other hand, in the first round of the trunk line analysis carried out, it was shown that routing to the islands, Ceuta and Melilla was problematic due to the need to lay underwater cable for these areas.

Broadband has been the subject of an exhaustive study into the analysis of markets 4 and 5. This analysis is reproduced here, but it is only considered relevant to show the retail market share for the broadband services on the Spanish mainland, the Spanish Island regions, Ceuta and Melilla, as has already been done in the Canary Islands, so as to assess whether there are any considerable differences.

Graph 0.1 Broadband shares by access type



Source: CMT based on the annual CMT requirements

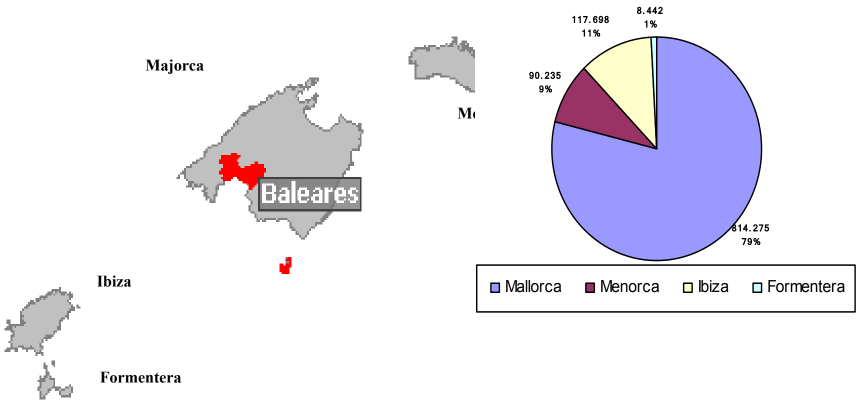
As can been seen, the Telefónica market share on the mainland is less that on the islands and in Ceuta and Melilla. It is worth pointing out that aside from the level of competition in the corresponding trunk routes, there may be other factors that influence this lower share.

For example, the smaller Balearic and Canary Islands have small and disperse populations which undoubtedly have a negative effect on an operator's decision to invest. See below for a brief descriptive analysis of the situation in the different areas.

- Balearic Islands:

The Balearic Islands are made up of four inhabited islands: Ibiza, Formentera, Menorca and Majorca.

Graph 0.2 Map and population distribution of the Balearic Islands



Source: CMT

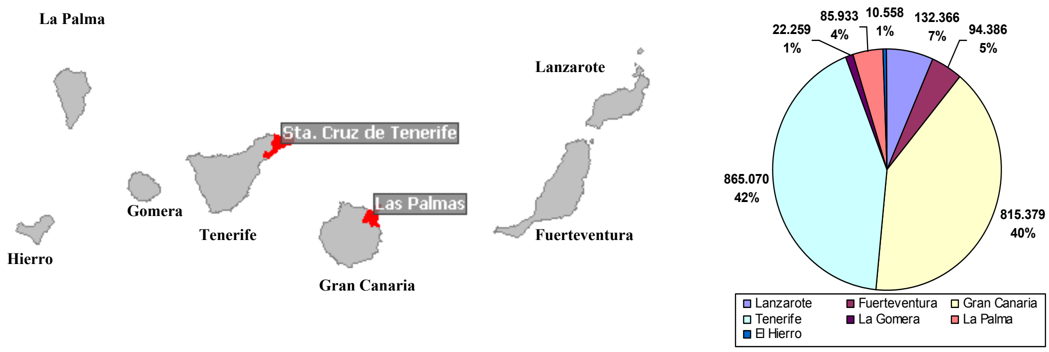
Approximately 80% of the Balearic population is located on the island of Majorca. Cable operators (the company ONO in this case) is present on this Island, as are unbundled loop operators. ONO's market share is significant (22.3%) as it is above the state average for cable operators. Additionally, it should be pointed out that ONO is not only present in the capital (Palma, Majorca), but also in numerous municipalities on the island.

On the rest of the islands there are neither LLU nor cable operators so it is only possible to contract broadband services from Telefónica or from an operator that uses indirect services from the incumbent operator.

- Canary Islands

The Canary Islands are made up of seven inhabited islands. La Palma, El Hierro, La Gomera and Tenerife are part of the Santa Cruz de Tenerife Province and Gran Canaria, Fuerteventura and Lanzarote make up the Las Palmas Province.

Graph 0.3 Population distribution on the Canary Islands



Source: CMT

The islands of Tenerife and Gran Canaria hold more than 80% of the population of the whole Canary Islands archipelago. In this sense, the situation with regards the distribution of the population is the same in each one of the Canary islands as in the Balearic islands: one main island with 80% of the population with the other 20% distributed over the rest of the islands. Nevertheless, the retail broadband competition situation is quite different in the Canary Islands than in the Balearics. Telefónica's market share is over 75%, unbundled loop is virtually inexistent and the cable operator market share (ONO) is only 13%. Additionally, cable is only present on Tenerife and Gran Canaria.

- Ceuta and Melilla

Ceuta has a population of 76,603 inhabitants, and Melilla's population is 69,440 inhabitants. There are no cable operators in these areas and no unbundled loop. Telefónica's market share is very high, standing at almost 100% in Ceuta.

II WHOLESALE MARKET OF RENTED TRUNK LINES

This section analyses the wholesale market of rented trunk lines, taking into consideration that:

a) In a considerable number of the routes it is one of the few wholesale markets with genuinely commercial characteristics.

b) On the other hand, for other routes with no alternative infrastructure, the rented trunk lines can be a bottleneck making competition difficult in the areas that it connects to.

II.1 Definition of the relevant market

II.1.1 Definition for the relevant product market

II.1.1.1 Delimitation between rented terminal lines and trunk lines

The service being analysed in this procedure is the wholesale rented trunk line service. As per Resolution 23 dated 23 November 2006 regarding market 14, these lines are defined as the wholesale circuits that are supplied between two of the applicant operator's nodes. Paying attention to usage, it was specified that an operator contracted these types of lines with the aim of constructing specific routes from their trunk network.[2]

In this way, the wholesale service of rented terminal lines can be told apart from the wholesale service of rented trunk lines as the applicant operator for the former service contracts the necessary network components for complementing their access network, whereas the wholesale service of rented trunk lines covers the needs of the operators by having certain transmission routes for joining two points of their trunk network. Therefore, the requirements that satisfy both services are clearly differentiated, as one service (terminal lines) replaces the lack of capillarity as it counts on a particular operator in areas in which an end client is appointed, whilst the other (trunk lines) looks to complement their transmission network in certain routes. In other words, whilst terminal lines[3] are related to the concept of area, trunk lines are concerned with the concept of the particular route.

II.1.1.2 Transmission speeds

The wholesale service of rented trunk lines is also different in terms of its transmission capacity. Nevertheless, this differentiation does not indicate that they belong to different markets. In this case the first round conclusions still apply which relate to the inclusion in the same market of all the trunk lines, independently of transmission capacity.

II.1.1.3 Physical support

One specific rented line can have different supports. In fact, it is very common that the low capacity lines are supplied via copper pair. The high capacity lines can be supplied over coaxial cable or optical fibre cables. Additionally, a multitude of circuits can be provided via radio-link. On the other hand, albeit under certain conditions, circuits can be supplied via satellite for international connections although this usage on a national scale is uncommon.

In any case, a circuit is determined by the technical specifications it meets and not by the physical support it offers, which should be transparent for the service user (a different operator in the trunk market).

[2] A Trunk network is defined as that which is developed to connect certain nodes such as switching exchanges, presence points and interconnection points forming the axis of the main connection of the operator network to which the subsidiary, smaller networks connect. It is also known as the transport network or the backbone.
[3] The rented terminal line market is described in detail in file MTZ 2008/1944.

Therefore, the reference market includes circuits provided over any type of support.

II.1.1.4 Ethernet

Ethernet technology is more and more common in operators' trunk network services. Therefore it is relevant to carry out a brief analysis to confirm whether these lines are included in the market:

One of the trends in the development of an operators' network is the extension to all the fields of packet commutation technologies. Whether it is equipment for supplying IP services or IP/MLPS[4] or Ethernet transport equipment, all have common use of interfaces based on Ethernet, from 100Mbit/s, 1Gbit/s or even 10Gbit/s. The proliferation of said interfaces in the equipment used in the trunk networks entails the demand for services with connectivity between different operator locations via Ethernet technology.

As well as offering transparent transport, when used by operators to support their trunk networks the rented Ethernet line services are regularly characterised as being high capacity due to the scarce use of 10Mbit/s interfaces in network equipment, and also as providing guaranteed, fixed broadband. Furthermore, they can ensure other quality parameters in keeping with the services supported over the operator network that contracts the rented Ethernet line service. In fact, the characteristics of the rented Ethernet lines in the trunk network setting are very similar to the traditional lines based on SDH/PDH.[5]

The development of traditional voice services into voice over IP services (VoIP) is another example of substitutability between Ethernet lines and traditional lines. If the traditional switching exchanges mainly use 2Mbit PDH interfaces and the transport network was based on SDH/PDH equipment, the new equipment that supports VoIP services makes extensive use of Ethernet interfaces, thereby allowing the transport networks of said services to also be based on equipment with these interfaces.
From the previous points it can be concluded that trunk lines with Ethernet interfaces are included in the reference market.

II.1.1.5 Dark Fibre

Lastly analysis needs to be carried out into whether there is substitutability between the rented lines and the rental of dark fibre. The main difference between dark fibre and rented lines is the technical characteristics and usage. Dark fibre is a service that is available to the user who contracts it from a physical medium, in particular, optical fibre. The operator only offers the transport medium with no other type of active element, in such a way that said user is the one that must "illuminate" the optical fibre via the corresponding transmission equipment.

From the point of view of demand, the users of this service are telecommunication operators that use it for constructing their transport network, as occurs with the rented trunk lines. In fact, to develop a network, an operator has three options:

[4]MultiProtocol Label Switching
[5] Synchronous Digital Hierarchy (SDH) and Plesiochronous Digital Hierarchy (PDH)

a) Roll-out their network using their own measures

b) Rent optical fibres from those that offer dark fibre and invest in the necessary equipment for illuminating the fibre.

c) Contract rented trunk lines from other operators.

The three options are not mutually exclusive; in general they tend to be complementary. In fact, an operator can build their network by contracting rented trunk lines and dark fibre from other operators to start to market their services in the fastest way possible and afterwards they can roll-out their own network in the preferred areas/routes at the same time as reducing their dependency on renting infrastructures out from third parties.

The decision between the two alternatives involving renting from other operators fundamentally depends on the investment profile of the operator and on transmission capacity requirements. The operator must assess the necessary costs and investments for building a network by renting trunk lines on one hand, and on the other, the use of dark fibre. The higher the capacity requirements, the higher the incentives for the operator to use dark fibre instead of rented lines, as whilst with rented lines the operator contracts a specified capacity, in the case of dark fibre it depends on the transmission equipment used by the operator which means the higher the capacity, the higher the yield obtained from the investment in equipment. Renting lines dedicated to other operators could be interesting in routes that do not absorb much traffic and that do not justify the necessary investment for illuminating the fibre.

From the point of view of service functionality, renting dark fibre brings an operator closer to roll-out of their own network rather than depending on third parties, as the applicant operator has significant control over the service via the management of the transmission equipment, whilst with rented lines the dependency on the supplier is absolute.

For these reasons, from the point of view of demand, the two services are not substitutes for each other.

For the substitutability analysis from the point of view of the offer, it must be considered that the majority of operators who currently supply dark fibre rental services tend not to actively supply the wholesale line rental service. This can be due to the fact that the decision to not supply dark fibre rented services and to supply wholesale line rented services instead requires significant changes to the business strategy and being equipped with more resources, both human and material, which is out of the business plan for these companies. Though the most expensive thing is the roll-out of the fibre itself, the companies that offer these services in Spain already do so by taking advantage of roll-outs that are used for distributing the main service they offer (electricity, gas, train transport), which makes the lay-out of the fibre no more than a marginal cost of the total.

In view of this, it can be concluded that dark fibre and rented trunk lines do not belong to the same relevant market.

In reality, the previous analysis shows that dark fibre is an upstream market in comparison to the rented trunk line market. In other words, an operator can offer rented trunk lines through the dark fibre. In any case, it is clear that the existing level of competition in the dark fibre market has an impact on the rented trunk lines as it allows an alternative operator to access the necessary infrastructures to self-provide the services of rented trunk lines albeit not sufficiently immediate for it to be included in the market.

The CNC agrees with the previous analysis, although it does believe it is relevant to more clearly show the valuation components which have lead to this conclusion. In their opinion, it would be desirable to have more information available about the different costs between the two solutions (dark fibre and rented lines) and the associated financial models.

In this respect, it is necessary to clarify that dark fibre requires some initial large investments, due to the fact that the necessary transmission equipment must be acquired first to illuminate the fibre and usually investments should be made to connect up with the fibre network of the service provider. For example, to use ADIF's (Spanish Railway Infrastructure Administrator) dark fibre it is the purchasing operator's responsibility to reach the ADIF network (one of the points of presence established by ADIF or a purpose built chamber on the side of the train tracks). On the other hand, the monthly costs for renting the fibre are reduced in comparison with the prices for rented circuits, above all keeping in mind that the transmission capacity is not limited.

In other words, via the rental of dark fibre, the average costs reduce inversely proportional to the increase in transmission capacity, whilst although there is a reduction with rented circuits, it is much less which is due exclusively to the fact that as the higher capacity circuits are contracted, the Mbit price also decreases.

The CNC also wants to go into more depth regarding the differences in control capacity over the network between the dark fibre and the rental of trunk lines, in particular taking into consideration that both cases are dependent on the renter.

Although it is true that with the services for rented trunk circuits and dark fibre the applicant operator depends on a service provider, the characteristics of the service are not the same, which leads to both services pertaining to different markets. The higher control over the dark fibre in comparison with the rented circuits from the point of view of the operator contracting the service, is due in the first instance to the there not being any limits to the capacity the operator can send through the fibre. In other words, it is in the hands of the operator to decide which equipment to use for illuminating the fibre. This equipment is what defines the transmission capacity available in the route in question. On the other hand, with rented circuits, a fixed capacity is contracted and pre-decided, and to increase upon this there is no other option but to contract more circuits or a higher capacity one which will entail higher costs. Apart from the distances, it is a similar situation to that which occurs in the unbundling of the loop and wholesale access to broadband. Whilst in the first case the operator can invest in equipment that allows them to offer speeds that are superior to the competition (as occurred in Spain when Jazztel introduced ADSL 2+), with wholesale access to broadband the operator is limited to the predefined capacities offered by Telefónica.

These functional differences have led to CMT considering wholesale renting of dark fibre to form part of a different market than that of rented circuits.

The CNC shows that the CMT does not appear to have checked whether the dark fibre can, in practice, be an upstream market in comparison with that of rented trunk lines. To accomplish this, the CNC suggests that the CMT investigate whether there are examples of operators that have rented dark fibre and who then sub-let it out in the form of rented trunk lines and whether this is compatible with what is laid out in the majority of dark fibre rentals.

In the first place, it should be clarified that the CMT Services have already indicated in the report submitted for public consultation that they consider dark fibre to be an upstream market in comparison with the leased trunk lines given the different functions, as previously described. In general terms, optical fibre leased by the operators is used to build their own circuits leased in self-supply and also for marketing it to third parties. In other words, the trunk lines that alternative operators market in the wholesale market are most commonly constructed over dark fibre leased from third parties.

Lastly, the CNC suggests the possibility of carrying out specific analysis of the dark fibre rental market in Spain.

In this current analysis, the CMT has obtained information regarding the dark fibre market and in light of this information it does not currently consider necessary the carrying out of further analysis of the fibre in addition to that carried out in this document. In fact, the main providers of dark fibre have reached agreements with the electronic communications operators with the latter not experiencing any problems with market access. Although there is the potential for carrying out said analysis in the future if new circumstances call for it.

II.1.1.6 Rented trunk lines for LLUs[6] or BSAs[7]exchange connections

The specific case of rented trunk lines is that in which they can be contracted by operators within the RUO framework. These lines allow for connection between authorised operators' nodes and the areas of co-location and remote location in the Telefónica premises. This service can also be used for the BSA or R-BSA connections for bit-stream access to the subscriber loop. This service is one more of the different types of Signal Delivery (hereinafter, SD) laid out in the RUO, as is SD with a multi-operator chamber or via radio-link.

Therefore, these types of lines are not analysed in the current market since they involve a resource associated with access to the subscriber loop. Therefore, Telefónica must continue to supply these types of lines in virtue of the obligations imposed on markets 11[8] and 12[9] (4 and 5 in the 2007 Recommendation).

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[6] Unbundling local loop
[7] Bit-stream Access Point
[8] CMT Resolution dated 11 May 2006 in which the market definition was approved for wholesale unbundled access (including shared access) to the loops and sub-loops for the purposes of supply of voice and broadband services and the analysis of same, to designate an operator with significant market power and to enforce specific obligations, and the European Commission was notified of the agreement (AEM 2005/1451).
[9] CMT Resolution dated 1 June 2006 in which the market definition was approved for wholesale unbundled access, and analysis of same, to designate an operator with significant market power and to enforce specific obligations, the European Commission was notified of the agreement (AEM 2005/1454).

II.1.1.7 Market for rented trunk lines in the Recommendation

The market for rented trunk lines corresponds with number 14 of the first Recommendation.[10] Nevertheless, in the explicative Memorandum of the new Recommendation, the European Commission shows that in all Member States network infrastructure has been built from alternative networks to that of the incumbent operator on the main routes. Therefore, the entry barriers in this market are reduced. A tendency has also been observed towards effective competition where the alternative operators have made sufficient investments in infrastructures and supply reference services in competition with the incumbent. The European Commission understands that this tendency is set to continue which has led them to decide to remove them from the Recommendation market. In any case, the Commission has also mentioned that routes can exist where there is only one supplier, in particular those that have little traffic.

II.1.1.8 Conclusion

The wholesale market of rented trunk lines is defined as being that in which symmetrical transmission capacity with no switching functionality is supplied which the user can control between two nodes of the applicant operator’s trunk network, independently of the technology used to supply the capacity.

II.1.2 Definition of the relevant geographic market

Once the relevant product market has been defined, the next step involves defining the geographical dimensions of the market. The initial analysis of this market concluded that the market reached a national level. Nevertheless, over the course of the document different characteristics can be seen regarding the routes to the islands and to Ceuta and Melilla.

As mentioned earlier, the product market consists of a route service which connects two points. It is evident that faced with an increase of between 5% and 10%, the applicant operators will not substitute this service for another that joins two different points. In paragraph 61 of the Guidelines, the European Commission indicates that in some exceptional cases the market can be defined route by route. This has been the practise of the Commission in cases IV/M.856 British Telecom/MCI, subjects IV/JV.15 BT/AT&T and COMP/M.2257 France Telecom/Equant, where the geographic markets were defined by route, specifically between country pairs. The Commission indicates that before defining markets on a route to route basis, the possibility of travelling through third countries or territories should be considered, or by using other technologies such as satellite for carrying out a broader definition of the market.

On the other hand, it must be pointed out that according to the Guidelines, a geographic market can be defined as a group of areas in which the competition conditions are homogenous (section 61). In the case of trunk lines, the terrestrial lines

[10] Commission Recommendation dated 11 February 2003, regarding the markets of products and services within the electronic switching market that could be the subject of ex ante regulations in accordance with the 2002/21/CE Directive of the European Parliament and Council regarding a common regulatory framework of the networks and the electronic switching services.

are different, whereby there are more competitive possibilities than the routes that have to cover a stretch of sea.

Aside from the mainland, Spain is made up of various physically separated territories and sections of open sea need to be crossed to access them. As previously stated, these territories are the Balearic Islands, the Canary Islands, Ceuta and Melilla. As established in the definition of the relevant market, there are different alternatives for the supply of the reference services (for example via radio-links or satellite connections). Nevertheless, for high transmission speeds which are necessary to connect the island territories to the mainland, optical fibre is the most efficient option.

The CNC concurs with the analysis carried out by the CMT although it specifies that satellite solutions do not represent viable alternatives for certain off-mainland routes due to higher costs and/or less transmission capacity.
In fact, the reasons for satellite links not being an efficient alternative to optical fibre cable are those given by the CNC: much higher costs and less transmission capacity than that available with optical fibre cable.

On the other hand, rented cross-water lines could also be supplied via radio-link, but there are limitations with regards transmission capacity which make them incomparable to an optical fibre connection. Whilst it is always possible to supply high capacity trunk lines over an underwater line, there is much lower available transmission via radio-links between islands, mainly due to the distance and due to the negative effects of sea propagation.

The different routes in each one of the territories are analysed below in accordance with the existing infrastructures.

II.1.2.1.1 Routes pertaining to the Balearic Islands:

There are two competitors in this archipelago: Telefónica, which reaches all the islands, and IslaLink that connects Majorca and Ibiza with the mainland. In accordance with the existing underwater cables, the following routes can be defined:

- Mainland– Balearics
- Majorca – Menorca
- Majorca – Ibiza
- Ibiza – Formentera

II.1.2.1.2 Routes pertaining to the Canary Islands:

In the Canary Islands the company Cable Submarino de Canarias (herewith, CSC) has underwater cables between Tenerife and Gran Canaria. The rest of the islands are only accessible via Telefónica infrastructures. By looking at the existing underwater cables, the following routes can be defined:

- Mainland – Canary Islands
- Gran Canaria – Tenerife
- Tenerife – La Gomera

- Tenerife – La Palma
- La Gomera – El Hierro
- Gran Canaria – Fuerteventura
- Gran Canaria – Lanzarote

II.1.2.1.3 Routes pertaining to Ceuta and Melilla:

Telefónica is the only company to have rolled-out infrastructures to connect to Ceuta or Melilla. In accordance with the existing underwater cables, the following routes can be defined:

- Mainland – Ceuta
- Mainland – Melilla

II.1.2.1.4 Overland routes

According to section 56 of the Guidelines, *"the relevant geographic market covers an area in which the companies affected participate in supply and demand of the relevant products and services, the competition conditions are similar or sufficiently homogenous and can be differentiated from the neighbouring areas as having considerably different conditions than the prevalent competition."* In paragraph 56, the European Commission specifies that *"in the electronic communications sector, the geographic scope of the relevant market has been defined by traditionally applying two main principals: a) the area covered by a network, and b) the existence of legal instruments and other regulations".*

With regards the previous point a), in the trunk routes supplied over land, network infrastructures have been constructed as alternatives to the incumbents' infrastructure. It is worth mentioning the presence of network operators from sectors other than telecommunications sectors (electrical sector, gas sector, ADIF,[11] postal service) that have rolled out dark fibre in a large proportion of routes.

Consequently, competition conditions are sufficiently homogenous both from the point of view of substitutability of demand and of supply for all terrestrial routes. Therefore, one single market can be defined that includes all the routes of rented terrestrial trunk lines.

II.1.2.2 Conclusion with regards market definition

The market definition of wholesale rented trunk lines is that in which symmetrical transmission capacity with no switching functionality is supplied on a wholesale basis and that the user can control between two nodes of the applicant operators' trunk network.

Likewise, in accordance with the different existing competition conditions, it is proposed that the geographic reference markets are defined as follows:

- Wholesale rented trunk lines for terrestrial routes.

[11] ADIF is a state company that manages tracks, stations, communications, etc., charging a toll to network users, among which is Renfe Operadora.

- Wholesale rented trunk lines for underwater routes. A market is defined for each one of the following routes:
  - Mainland – Balearics
  - Majorca – Menorca
  - Majorca – Ibiza
  - Ibiza – Formentera
  - Mainland – Canary Islands
  - Gran Canaria – Tenerife
  - Tenerife – La Gomera
  - Tenerife – La Palma
  - La Gomera – El Hierro
  - Gran Canaria – Fuerteventura
  - Gran Canaria – Lanzarote
  - Mainland – Ceuta
  - Mainland – Melilla

II.2 Analysis of the criteria established by the European Commission to identify markets susceptible to *ex ante* regulation

In accordance with article 10.1 of the LGTel, *"the Telecommunication Market Commission, keeping in mind European Commission Guidelines for market analysis and identification of operators with significant market power, as well as the Recommendations of Relevant Markets, it will define, via a resolution published in the Spanish Official Journal, the reference markets relating to networks and electronic communication services, among which will include the corresponding wholesale and retail reference markets and their geographic fields, characteristics of which can be justified by the imposition of specific obligations".* In this sense, the Commission's Recommendation dated 17 December 2007 established that, upon identifying different markets from those outlined in the Annex, the NRA has to ensure that they accumulatively satisfy the three pre-established criteria for determining whether a market is susceptible to *ex ante* regulation.[12]

In accordance with the European Commission, *"[the] application of the three criteria should limit the number of markets in the electronic communications sector where ex ante regulatory obligations are imposed, contributing therefore to the aim of the regulatory market to progressively reduce the ex ante sectoral regulations as competition develops in the market. These criteria should be accumulatively applied, namely, not meeting any of them will mean that the market should not be included with those which can be subject to ex ante regulation"* (section 14).

Therefore, a market identified by an NRA at a national level may not be susceptible to *ex ante* regulation in the case of it not complying with one of the three criteria as established by the European Commission in their Recommendation.

[12] Section 5 of the Recommendation: "With the aim of identifying the markets that could be subject to ex ante regulation, it is useful to apply the following accumulative criteria. The first criterion is the presence of significant, non-transitory obstacles to market access, be them structural, legal or regulatory. Nevertheless, given the dynamic character and functionality of the electronic communications market, at the time of carrying out prospective analysis for identifying the relevant markets with views towards possible *ex ante* regulation, it is recommendable to also take into consideration the possibilities of overcoming these obstacles that hinder access within the relevant temporal horizon. The second criterion only chooses those markets whose structure does not tend towards effective competition within the relevant temporal horizon. The application of this criterion implies the examination of the competitive situation behind these access obstacles. The third criterion is the one in which the mere application of legislation on the competition situation does not allow suitable attention to be paid to the failures of the market in question".

In this sense the markets of rented trunk lines are not included in the Recommendation Annex as, prior to analysis of this market type, it is necessary to determine whether it is a market that is susceptible to *ex ante* regulation in accordance with the aforementioned criteria.

Additionally, included in the rented trunk line market is the terrestrial trunk market and a series of underwater trunk markets (one for each route). Both have different characteristics which led to the criteria test being carried out separately. Firstly, the terrestrial trunk lines were analysed and then the underwater trunk lines.

Said analysis is carried out in accordance with the ERG document "Guidance on the application of the three criteria test".[13]

II.2.1 Rented trunk lines for terrestrial routes

II.2.1.1 Presence of non-transitory entrance barriers to market access

The aim of this first criterion is to analyse the structural elements and legal obstacles that in the previously defined market can affect the entry of other operators or the expansion of currently existing ones. As established by the Recommendation, *"the structural obstacles are derived from an original situation of demand or costs that create asymmetrical conditions between historical operators and the new operators which make market entry difficult or prohibitive, for the latter group".*

Likewise, upon carrying out analysis into the market entry barriers, it must be considered whether these are susceptible to being non-transitory, following a *modified Greenfield approach*, namely, keeping in mind the current obligations in the related wholesale markets but not the asymmetrical regulations imposed on the services that are the subject of the analysis.

II.2.1.1.1 Legal or regulatory obstacles

With regards the existence of this type of obstacle, the Recommendation notes that these *"are not based on the financial situation and instead are derived from legislative, administrative or public measures in general, that have direct repercussions on the entrance conditions and/or positioning of the operators in the relevant market".*
The main legal obstacles that can arise in the electronic communications market are as follows:

- Need to obtain administrative authorisation or a license for operating in the market
- Having user concessions in the radio-electric spectrum.

In relation to the reference market, there are no entry obstacles of this type. Firstly, the licence regime has been abolished and instead there is a more flexible system of authorisations that involve a less administrative load for the operator. Secondly, a radio spectrum is not required for supplying the services included in the reference market. Consequently, it can be confirmed that there are no legal or regulatory obstacles for market entry.

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[13] ERG (08) 21 ERG Report on 3 criteria test final 080604.

II.2.1.1.2 Structural obstacles

With the aim of assessing the magnitude of structural obstacles, a series of variables are analysed below which evaluate whether barriers exist to the high, non-transitory level of market entries into the reference market.

The structural obstacles faced by the alternative operators are the hidden costs and the lesser economies of scale and scope. The hidden costs are defined as being those required by the operator to enter the market and which cannot be recuperated when the company exits the market. The economies of scale are defined as the advantage of costs that a company obtains as their production increases, and the economies of scope refer to the efficiencies achieved by a company when they supply a range of services using one infrastructure, for example in the electronic communications market. It is relevant to point out that in the case of trunk lines, while the service that is supplied relates more to routes than to coverage zones, the hidden costs are not as relevant as with roll-out of an access network.

Furthermore, although there may not be any regulated, upstream wholesale services to the rented trunk lines, a very dynamic market is supplied in the absence of regulations since the start of the liberalisation, namely, dark fibre. In this market the most relevant actors are companies with a network infrastructure: ADIF, Gas Natural, REE, Iberdrola, Endesa, Abertis, etc. These companies have taken advantage of the roll-outs that were carried out for distributing the main service that they offer (electricity, gas, rail travel, motorways, etc.) for laying dark fibre, so therefore laying the cable has not incurred any more than a marginal cost over the total.

The extension and scope of the networks of these operators (rail, natural gas and electrical networks are all very extensive) has facilitated the existence of dark fibre in large quantities over national routes.

An example of this is shown in the data from some of the relevant dark fibre providers:

- ADIF[14]: They have 12,000km of cabling. They have 155 points of presence and interconnections with all the operators
- Spanish Electricity Network (REE)[15]: they have 21,300km of cabling and 175 access points
- Iberdrola[16] has 13,000km of optical fibre
- Desarollo del Cable (subsidiary of Gas Natural) has more than 6,500km of fibre.

In general, it can be confirmed that the operators approach ADIF, Gas Natural (via their subsidiary Desarrollo del Cable) and REE to connect to the province capitals and most relevant cities. Additionally, dark fibre from electrical companies and other smaller suppliers has even allowed (for cable operators in particular) access to numerous localities of reduced size where the economies of scale may have made the roll-out of an alternative network difficult.

[14] http://www.adif.es/telecomunicaciones/index.html
[15] http://www.ree.es/operacion/red_fibra_optica.asp
[16] http://www.iberdrola.es/wcorp/corporativa/iberdrola?IDPAG=ESTELECOMU&codCache=12076187413587

To summarise, the alternative operators have been able to approach these agents to build their trunk network and, among other things, offer rented trunk lines to third parties. Additionally, as alternatives do exist, operators have been able to negotiate with dark fibre agents and obtain competitive prices, thereby reducing both the level of hidden costs and disadvantages in comparison with Telefónica due to the lesser economies of scale and scope.

The previous point implies that alternative operators do not depend on the infrastructure controlled by Telefónica in the upstream market to build their trunk network in the large majority of the routes.

This reasoning is corroborated in practise as Spanish operators count on an extensive trunk network (as an example, Annex 2 presents two case studies which show how each alternative operator's trunk networks combine their own networks with the rent of dark fibre or rented circuits).

Consequently, due to the fact that a rented trunk line is a service that covers routes (not areas) and due to the existence of a dynamic, upstream market in comparison with the trunk networks (dark fibre), it can be concluded that there are no existing structural barriers to the high number of non-transitory market entries.

The CNC notes an apparent contradiction between the non-inclusion of fibre in the reference market and then later arguing its existence to justify that entry barriers are reduced. The CNC reiterated their comment made earlier regarding the potential consideration of fibre as an upstream market in comparison with rented trunk lines. The CNC's comments advise that it is worth remembering that the CMT already indicated in the public inquiry that it considers dark fibre to be an upstream market in comparison with the rented trunk lines. It is evident that the more competition and access potential there is in this wholesale market, the less entry barriers there will be in the downstream market, including the reference market. The existence of entry barriers is a relevant criterion when analysing the competitive situation of a market.

Lastly, the CNC, the Generalitat de Catalunya and Orange believe that there isn't sufficient information available regarding the degree of geographical extension of the dark fibre offer or of the roll-out of networks by Telefónica's competitors, and therefore it cannot be determined whether the existence of an alternative offer could be sufficient in certain routes, and in particular between province capitals and smaller towns.

With regards this question, Annex 2 of the public inquiry presents two case studies regarding the trunk network of two alternative operators. In the Annex the CMT arrived at the conclusion that the alternative operators did not depend on Telefónica for building their trunk networks.

It should be pointed out however that there is not only dark fibre between province capitals but also between province capitals and smaller municipalities. For example, ADIF has a fibre layout over a large part of its railway network, including its local services. Furthermore, in the sections of network where there is no fibre, this is due to there not being the demand from operators, and in the case of demand increasing, it could be rolled out in a relatively short period of time. This is a very relevant point as between the different suppliers of dark fibre services there are access rights throughout the whole country and on hypothetical routes which do not have fibre, it tends to be available to roll-out when requested by the operators.

Additionally, it is important to note the capillarity of the fibre networks of electrical energy companies such as Endesa or Iberdrola, who most certainly reach further a field than province capitals. For these companies, the demand from the telecommunication operators is not the only factor that drives them to roll out fibre, there is also self-supplying as a result of the automation of the management of the electrical network.

In this sense, network roll-out by cable operators in Spain is very important, in particular in some areas of ONO (specifically the areas covered by ONO prior to the take-over of Auna), Euskatel, Telecable and R. These operators reach a large number of municipalities, many of them with populations below 10,000 inhabitants and they have built the necessary trunk network to reach these populations thanks to agreements with various dark fibre suppliers.

An illustrative example of this is the roll-out of ONO on the island of Majorca, in which, despite its insular nature, they are present in the capital and in the following municipalities: Binissalem, Calvia, Campos, Felanitx, Inca, Lloseta, Llucmajor, Manacor, Marratxi, Muro, Santa Margalida, Santa Maria and Sa Pobla. To accomplish this, ONO has turned to various dark fibre suppliers, some of them local, and has not needed to use Telefónica’s trunk lines.

The previous point shows that there is a clear will to roll-out alternative networks. Therefore, the conclusions reached in the public inquiry remain valid.

II.2.1.1.3 Conclusions with regards the first criterion

There are no high, non-transitory entry barriers. A rented trunk line is a service on a route and not in an area, which to a large degree lessens the barriers that could exist as a consequence of incurring hidden costs or the economies of scale and scope that Telefónica enjoys. Additionally, the existence of a dynamic, dark fibre upstream market allows for market access without the need for roll-out of a company’s own infrastructure which considerably limits entry barriers.

In prospective terms it can be said that when the alternative operators reach a higher market share and critical mass in the different retail markets, they will then extend their transport networks via their own infrastructures to gain economies of scale.

To summarise, it can be concluded that the first criterion for considering whether a market is susceptible to *ex ante* regulation is not met.

In accordance with the Recommendation, meeting the three criteria should be accumulative, in other words, if one of them is not met, the market will not be susceptible to regulation. Nevertheless, from carrying out the analysis in the most exhaustive way possible, analysis is carried out below into whether the market definition complies with the other two additional criteria that the EC indicate in their Recommendation.

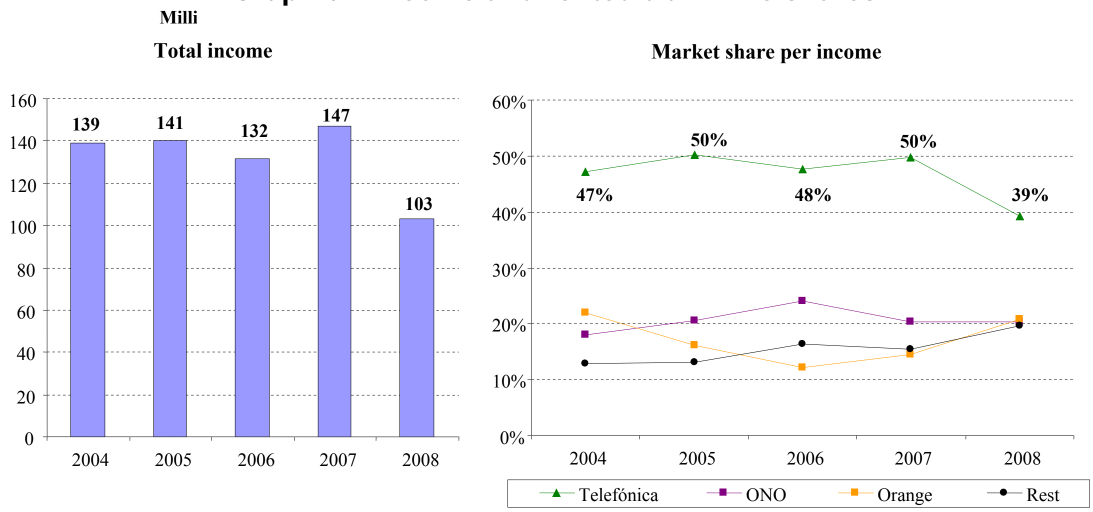
II.2.1.2 Tendency towards effective competition

To evaluate the possibility that a market tends towards effective competition within the time period studied, indicators such as market share, existing competition, price evolution or potential competition should be considered.

II.2.1.2.1 Market shares

The following graph shows the total market income and the development of market shares in terms of Telefónica's income and that of the most relevant operators in the terrestrial rented trunk line market:

Graph 0.1 Income and rented trunk line shares



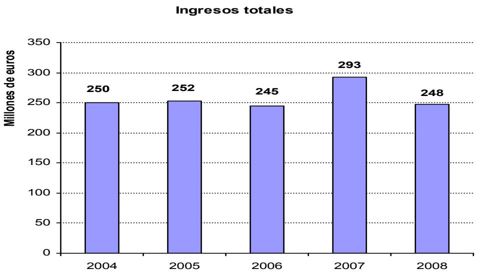
Source: CMT based on the specific requirements of the current analysis.

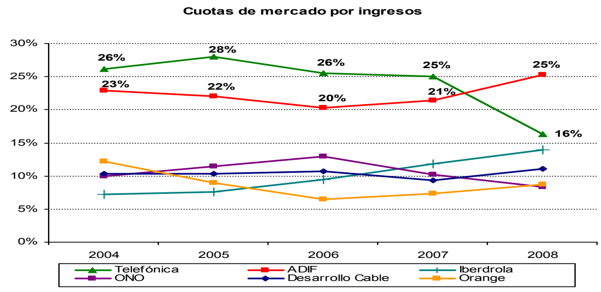
During the period studied in the sample, Telefónica's market share remained stable until 2007 with small oscillations around the 50% mark. Nevertheless, from 2007 to 2008 there was a significant reduction in Telefónica's market share, down to 39%
.
The rest of the operators have a share of the other half of the market, with Orange and ONO the most prominent who together have approximately 40% of the market.

Additionally, bearing in mind the dark fibre market, although it is concluded that dark fibre and trunk lines do not belong to the same reference market, it is relevant to carry out the exercise of calculating Telefónica's hypothetical market share including income from dark fibre in the market.

Graph II.2.2 Income and rented trunk line and dark fibre shares

Total income/millions of euro *Market share per income*





Source: CMT based on the specific requirements of the current analysis.

In this regard, Telefónica's share was the highest until 2007, but in 2008 it was overtaken by ADIF. In this sense, it is important to show that a rented trunk line is a service with higher added value than the dark fibre (as said, they do not belong to the same market). In other words, the income of the operators who supply trunk lines are overestimated with regards those supplying fibre. Therefore, it is reiterated that the previous exercise is merely theoretical as being precise, the income for dark fibre and for trunk lines are not directly comparable.

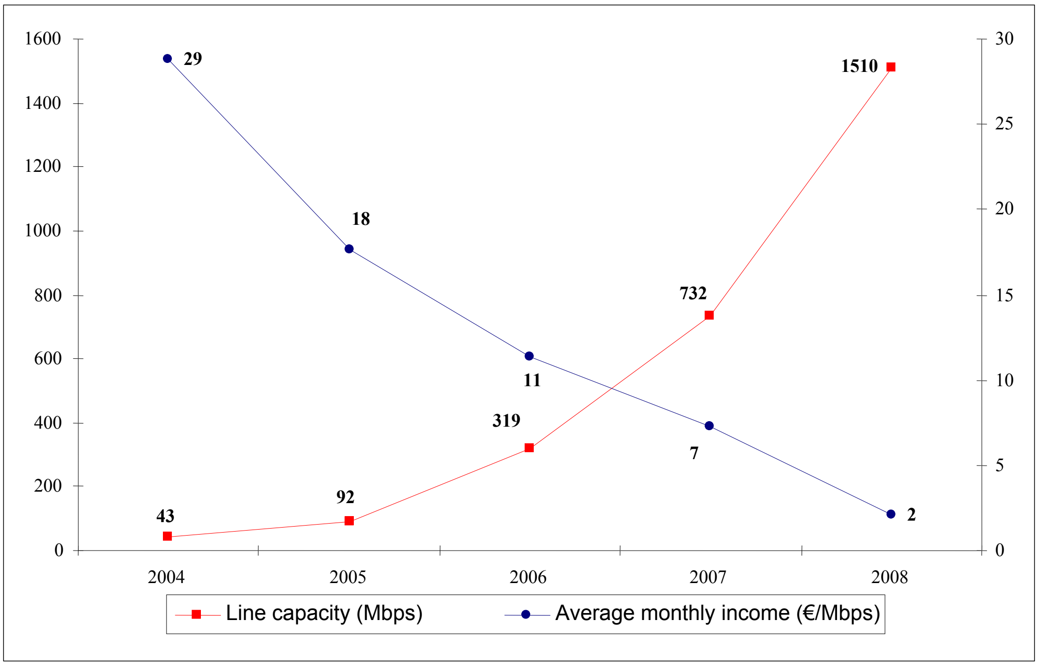
On the other hand, it should be kept in mind that the rented terrestrial trunk lines have been the subject of light regulation by the CMT (for example with price regulations). As a consequence, prospectively everything points to the fact that in the absence of market regulation it will behave very similarly as it has been doing to date.

II.2.1.2.2 Price evolution

- *National comparative*

The average price evolution per circuit, independently of the speed, gives a deceptive result as the proportion of circuits with high speeds is always increasing. To make an adequate comparison there are two particularly relevant pieces of data: the development of the average speed per line and the average income per Mbit/s. Both parameters are presented below:

Graph II.2.3 Average price evolution per Mbit/s



Source: CMT based on the specific requirements of the current análisis.

The average capacity in Mbit/s has almost multiplied by 35 in the last five years. This is due to a significant reduction in the number of 2Mbit/s circuits and a general reduction in the number of circuits with speeds equalling or less than 155Mbit/s, with the logical exception of Fast Ethernet (100Mbit/s), which has increased, as have the circuits with speeds above 622Mbit/s.

The previous increase is accompanied by a very significant decrease in the average price per Mbit/s, which has reduced by more than 90% in recent years.

II.2.1.2.3 Potential competition

The main competitive threat that operators in the rented trunk line markets face comes from operators that supply dark fibre services. Faced with a significant rise in line prices, they could decide to illuminate their fibres and directly supply rented trunk line services themselves or they could even create or join up with an operator that is exclusively centred in the telecommunications market.[17]

In any case, as explained above, the dark fibre operators are undoubtedly disciplined in the behaviour of the operators that are present in the rented trunk line markets, as they make self-supplying by alternative operators credible.

II.2.1.2.4 Conclusion in relation with the second criterion

Telefónica’s market share is situated at around the 40% mark, the average capacity per line has increased significantly and the average income per Mbit/s has reduced by more than 90% in the last five years and all of this in the absence of price regulation.

[17] As has occurred with Neo Sky and Iberdrola

The CNC and Orange have shown that the stability of Telefónica's share (around 50%) is not conclusive with regards non-compliance of the second criterion. Furthermore, in CNC's opinion, the significant fall in the average price per Mbit/s does not necessarily imply a tendency towards effective competition as this needs to be done in a relative manner whilst at the same time increasing the average capacity per line.

In this regard it should be pointed out that in the public inquiry only data from the year 2007 was available. In 2008 Telefónica's market share decreased to 39%, which reinforces the preliminary conclusions already reached by the CMT services.

On the other hand, Telefónica has also been asked for additional information regarding the circuit capacity that has allowed for the estimates of average circuit capacity and price per Mbit to be sharpened. The new results are conclusive: in five years the average circuit capacity has multiplied by 35 and the average price of Mbit/s has decreased by more than 90%.

Independently of the previous point, this Commission does not share the observations of the CNC with regards the evolution of the price per Mbit/s. Keeping in mind that the CMT has not imposed the supply of a particular speed on Telefónica, the increase of average speed offered is an important figure. The CNC appears to assume that the increase in average speed via a circuit is an automatic process unlinked to market conditions and this could not be further from the truth. For the average circuit speed to increase it is necessary that the operators present circuits in the market offer that have increasing capacity. In the absence of competition, it is common that the operator with significant market power restricts their offer and rejects all applications for high capacity circuits. In fact, the CMT stated that Telefónica carried out this practise in the analysis of the supply conditions for the Mainland – Canary Island route.

The previous point can be explained by the alternative infrastructures available, many of them rolled-out by operators that market dark fibre services. There is no doubt that the existence of these operators disciplines the competitors in the trunk markets. If the income was included from fibre in this market, Telefónica would be the second operator in the market with a share of barely 16%.

Therefore, the conclusion to be drawn from the analysis of the second criterion is that the rented terrestrial trunk lines are tending towards being competitive.

II.2.1.3 Sufficiency of Competition Law

According to the Market Recommendations, the third criterion that a market must meet to be susceptible to *ex ante* regulation involves determining *"whether legislation regarding competition is sufficient for correcting the market failures which result from the compliance of the first two criteria".*

The European Commission considers that *"probably, competition legislation will not be sufficient if it is intervention for correcting a failure in the market needs to meet multiple requirements or when frequent and/or exact intervention is indispensable".*

According to article 24 of Law 15/2007, of the 3 July, from the Competition Defence (herein LDC), *"the National Competition Commission is the competent body for instructing and resolving issues revolving around this Law and in particular: (a) applying the points laid out the current Law regarding competition-restricting behaviour [...]; (c) applying articles 81 and 82 of the European Community Treaty and its resulting laws in Spain [...]".*

Therefore, according to article 48.2 from the LGTel, *"the Comisión del Mercado de las Telecomunicaciones (CMT) must establish and supervise the specific obligations that market operators have to comply with, boost competition in the audiovisual services market in accordance with its regulatory rules, resolve conflicts between operators and where necessary, act as arbitration body for any disputes between them".* Likewise, according to article 48.3 of the LGTel, the CMT exercises the following functions: *e) Adopts necessary measures for safeguarding the plurality of the service offer, access to the electronic communication networks by operators, network interconnection and operation of network in open network conditions, price policies and marketing by the service suppliers* [...]".[18]

As shown previously, the rented terrestrial lines have been subject to light regulation by the CMT without there being a regulated price framework, highlighting the existence of a significant number of alternative infrastructures which have been rolled-out and marketed by various different operators.

On the one hand this situation has favoured investment in infrastructures by alternative operators, and on the other, an environment of low or no conflict between them all. The CNC notes that it has not estimated to what measure the existence of *ex ante* obligations has prevented the presence of disputes.
Therefore, certainly the reduced degree of conflict can be in part due to the existence of a stable regulatory market in keeping with which certain obligations have been developed for the operator with significant market power. Nevertheless, in the CMT's opinion, the development of this service and the behaviour of the agents in the market allows for the conclusion to be drawn that from a prospective point of view, even in a deregulated environment the degree of increase in existing conflict would not be predictable, given the presence of competitive forces that are set up as alternatives to TESAU's regulated offer that currently exists.

In any case, the competent authorities avail of the necessary resources and skills for testing the existence of competition-restricting practices in an *ex post* context in the case that a formal complaint were to be submitted by an alternative operator.

[18] As shown by the Spanish High Court, "[...] it is certain that the law expressively authorises the [CMT] to impose behavioural obligations On certain operators with the aim of avoiding anticompetitive practice, although the direct general application of the competition defence regulations are not within the actual authority of the CMT. Consequently, in the event of noticing a practice that could be in contrary to "the plurality of offers", the regulatory body can impose different types of obligations on operators, which may or may not be performed, and in the case of inobservance of the mandate, the CMT could exercise their sanctioning powers [...]. The edit of the current section e), 3rd paragraph, article 48 of Law 32/2003 [...] authorises the CMT to impose "specific" and "individual" measures with which operators in the Telecommunications Market must comply, as this is their purpose [...], Sentence from the Audiencia Nacional (Spanish High Court) dated 1 March 2006 (rec. no. 1219/2003); also see the sentence from the Audiencia Nacional dated 22 July 2007 (rec. no. 83/2005); and sentence from the Audiencia Nacional dated 17 July 2007 (rec. no. 529/22004).

To summarise, it is considered that *ex post* intervention is sufficient for solving market failures that could have been produced in the reference market. Therefore, it can be concluded that the third criterion for a market to be considered susceptible to *ex ante* regulation is not met.

II.2.1.4 Conclusions regarding achieving the three criteria set by the European Commission market Recommendation

Exhaustive analysis has been carried out in this document into the criteria that a market should meet with to be susceptible to *ex ante* regulation in accordance with the European Commission market Recommendation.

The following conclusions have been drawn:

- There are no significant entry barriers to the reference market as structural obstacles are more reduced (as it is a route service) at the same time a large number of dark fibre suppliers lessens the barriers that could exist in relation to hidden costs and economies of scale and scope.
- Although Telefónica's market share stands at around 50%, the average prices of the services included in the reference market have decrease and the capacity of the circuits have increased considerably.
- Anticompetitive practice can be solved via *ex post* intervention (sufficiency of competition legislation).

The CNC notes that it does not see significant variations from a regulatory point of view, or in market structure with regards those highlighted in the market analysis approved in 2006, where different conclusions were reached.

As opposed to what the CNC state, there are very significant variations with regards those observed in the first market analysis. Specifically:

- Telefónica's market share in 2008 stood at 39%, whilst the share calculated for 2004 in the first analysis was 73%.
- The average capacity per circuit and the price per Mbit/s have varied significantly since 2004.

Therefore, in accordance with the previous evidence, the conclusion is put forward that the wholesale market of rented terrestrial trunk lines does not meet the three criteria that allow it to be identified as a market susceptible to *ex ante* regulation.

II.2.2 Rented trunk lines for underwater routes

Once the three criteria test has been carried out for the terrestrial trunk lines, it is necessary to then carry it out for the underwater lines.

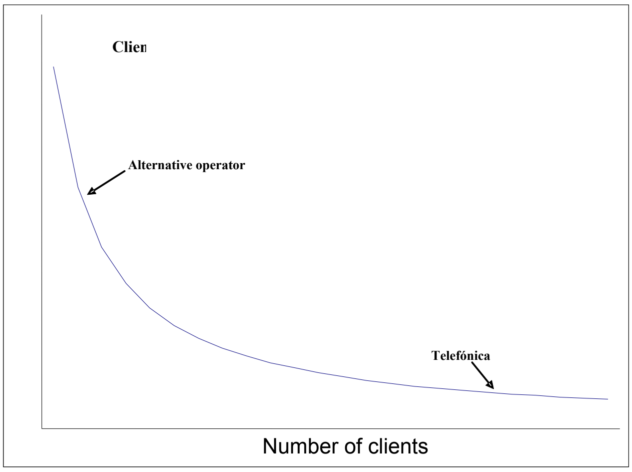
II.2.2.1 Presence of non-transitory entry barriers for market access

Unlike what happened with the terrestrial lines, in the case of the underwater lines there barely exists any alternative infrastructures to Telefónica's ones. The absence of alternatives can be explained as follows:

- The hidden costs for these types of lines are high given that an operator faces a high investment which it will lose if it is ejected from the market.

- The economies of scale are very relevant. The average costs faced depend on the number of clients. This situation is particularly serious for the areas with lower populations such as Menorca and Ibiza in the Balearics, Ceuta, Melilla and the smaller islands of the Canary Islands archipelago. The following graph represents the average investment curve by client when laying an underwater cable. The investment in absolute terms for Telefónica and the alternative operator is the same. Nevertheless, the investment per client is substantially higher for the alternative operator as its market share is smaller.

Graph II.2.4 Economies of scale and underwater cables



Source: CMT

For the trunk lines to the larger islands, the entry barriers continue to be high, but not insurmountable. It is of note that IslaLink has rolled-out an underwater cable between the mainland and Majorca. However, between the mainland and the Canary Islands there are no alternatives but currently various cabling projects are being studied for underwater cabling using optical fibre connections between Europe and the East of Africa[19] that offer an opportunity for roll-out of an underwater cable on the route. An alternative operator could decide to join one of these projects and thereby reduce the high investment required and in turn, the hidden costs for laying this kind of infrastructure. In any case, it is important to keep in mind that lay-out of underwater cabling is a venture which requires time and the entry of any competitor can be ruled out until 2010.
In the rest of the routes the entry of a competitor would also seem unlikely. In any case, the possibility of entry in the Mainland – Canary Island route will be taken into consideration when identifying the competition problems in the imposition of obligations.

All these reasons point to the existence of significant structural entry barriers in the underwater trunk line markets.

Therefore, the first criterion for considering that a market is susceptible to *ex ante* regulation is met.

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[19] Two examples:
- Main One: http://www.tycotelecom.com/AboutUs/content.asp?page=view&type=Press&id=311.
- Infinity Worldwide Telecommunications Group of Companies Holding Limited: http://www.eldigitaldecanarias.net/noticia925.php

II.2.2.2 Tendency towards effective competition

The application of this criterion involves examining the state of the competition that is behind the entry barriers, that is, even in those markets that are characterised by high entry barriers a sufficient number of operators may exist to guarantee that the market tends towards effective competition.

Again, indicators such as market share, existing competition, price evolution or potential competition should be evaluated.

II.2.2.2.1 Market shares

The underwater routes should be distinguished between those in which there are currently no alternative infrastructures to Telefónica's and those where alternatives do exist. The first type is as follows:

- Mainland – Ceuta
- Mainland – Melilla
- Mainland – Canarias
- Tenerife – La Gomera
- Tenerife – La Palma
- La Gomera – El Hierro
- Gran Canaria – Fuerteventura
- Gran Canaria – Lanzarote
- Ibiza – Formentera

In all the aforementioned routes, Telefónica is the only supplier of rented trunk lines and their market share has always been 100% both in terms of lines and income.

On the other hand, there is at least one other active competitor on other routes which reduces Telefónica's market share to below 100%. Therefore, the situation in each one of the following routes will be analysed below:

- Mainland – Balearic Islands
- Majorca – Menorca
- Majorca – Ibiza
- Gran Canaria – Tenerife

<u>Mainland – Balearics:</u>

In the section corresponding to the retail markets, it is shown that the market share for ONO's broadband services in the Balearic Islands is over the national cable average. ONO's coverage in Majorca is also pronounced: it is present in Palma and in another 13 municipalities. The rest of the alternative operators have co-located in the largest Telefónica exchanges in Palma and the surrounding areas.

With regards the trunk market, IslaLink started to operate in the mainland-Balearic route in 2001. Additionally, the Abertis group supplies low capacity links on this route from the start of liberalisation. The evolution of the size of the market and market shares for these three operators is presented in the following graphs:

[CONFIDENTIAL]

There is a noticeable increase in the size of the market for this route, due to the following factors:

- Increase in the penetration of broadband
- Increase in average speed per connection
- Growth of ONO's market share in the retail markets
- Opening of LLU exchanges by the alternative operators

IslaLink is the operator with the highest market share, although Telefónica is not far behind them. The development of the market shares indicated that the market tends towards effective competition.

<u>Majorca - Menorca:</u>

In this route, the only alternative to Telefónica are the Abertis radio-links. The size and share of the market is as follows:

[CONFIDENTIAL]

It is a small, decreasing market. It is made up of circuits contracted by mobile operators as in Majorca there are no cable or LLU operators present.
Although Abertis holds a 23% market share, the service from this operator is made up of 2Mbit/s radio-links which prospectively cannot be considered as substitutes for the fibre trunk lines, so, from this point of view, practically all the market share is held by Telefónica.

<u>Majorca - Ibiza:</u>

IslaLink stared to offer circuits on this route in 2006. Abertis also supplies some 2Mbit/s circuits via radio-link.

[CONFIDENTIAL]

As is the case with Majorca – Menorca, this is a smaller route due to the absence of cable or LLU operators in Ibiza. Practically all the market demand comes from the mobile operators. The decrease in 2006 was due to price reductions caused by the entrance of IslaLink. **[CONFIDENTIAL]** IslaLink was the operator with the highest market share in 2007, although Telefónica managed to recover its leadership in 2008.

<u>Gran Canaria – Tenerife:</u>

CSC has operated in this route since 2002. Additionally, Abertis offers low-capacity circuits here too.
The market shares and sizes are as follows:

[CONFIDENTIAL]

It is a market with a growing trend and is made up of circuits contracted by ONO (present in Tenerife and Gran Canaria) and mobile operators. The growth is fundamentally due to the increase in the capacity required by ONO. CSC and Telefónica had similar market shares in 2008. Abertis was also present in this route offering some 2Mbit/s circuits.

II.2.2.2.2 Price Evolution

From the analysis of the information required from the operators, it is observed that Telefónica has reduced the prices in the three underwater routes with other alternatives.

This is particularly significant in the mainland – Balearics route where Telefónica is offering high capacity circuits in very competitive conditions. Additionally, some confidential data was given earlier regarding what has happened with the Majorca – Ibiza route prices with the entrance of IslaLink. On the other hand, in the routes with no alternatives, the prices have not seen any significant price changes.

II.2.2.2.3 Prospective Analysis

During the period covered by the current review, no competition is expected to enter the market, so the situation is expected to remain stable both in the routes with alternative operators and those in which only Telefónica is present.

The only exception is, as previously mentioned, the possibility of the entry of another operator on the Mainland – Canary Islands route, under the protection of an international consortium that rolls-out a cable system between Europe and West Africa. In any case, the time period required for executing such a project makes any effective entry into the market improbable during the period covered by the current market analysis.

II.2.2.2.4 Conclusion with regards the second criteria

In accordance with the analysis of size development, market shares and prices, the following conclusions have been reached:

1. Telefónica's market share is practically 100% and the current prices have not changed in the following routes:

   - Mainland – Ceuta
   - Mainland – Melilla
   - Mainland – Canarias
   - Tenerife – La Gomera
   - Tenerife – La Palma
   - La Gomera – El Hierro
   - Gran Canaria – Fuerteventura
   - Gran Canaria – Lanzarote
   - Ibiza – Formentera
   - Majorca – Menorca

   Therefore it is considered that the second criterion is met (there is no tendency towards effective competition) for the markets that cover the aforementioned routes.

2. On the other hand, for the three remaining underwater routes, the evolution of the market shares show a high level of competition between Telefónica and another provider. Additionally, an increase in the speeds offered and a decrease in prices can be observed.

   - Mainland – Balearics
   - Gran Canaria – Tenerife
   - Majorca – Ibiza

   Therefore, it is considered that the second criterion is not met (given that a tendency towards effective competition is noted) for the markets covering the abovementioned routes.

II.2.2.3 Sufficiency of the Competition Law

In accordance with the market Recommendation, the third criteria that should be met by a market for it to be susceptible to *ex ante* regulation involves determining *"whether the competition legislation is sufficient for overcoming the market failures resulting from meeting the two previous criteria".*

The European Commission considers that *"probably, competition legislation will not be sufficient if it is intervention for correcting a failure in the market needs to meet multiple requirements or when frequent and/or exact intervention is indispensable".*

The third criteria is analysed below, paying particular attention to the criteria fixed by the ERG in their document *"Guidance on the application of the three criteria test"*.

<u>*Degree of generalisation of non-competitive behaviour*</u>

In contrast to the terrestrial trunk line, the alternative operators have put to the CMT on various occasion the need to regulate the routes to and between the islands, as well as to Ceuta and Melilla (for example in the first market review and more recently in the Resolution of the Canary Islands cable offer). In this sense, following the approval of Market 14, this Commission in their Resolution of the 10 September 2008 should have proceeded to modify the Reference Line Rental Offer regarding the Mainland – Canary Island route (hereinafter, the Canary Islands' RLO). Amongst the modified questions were prices, services, capacities and other components that Telefónica must offer to alternative operators. The Resolution mentioned the existence of an excessive price problem in the mainland – Canary island route which negatively affected the level of competition of the retail services (broadband in particular) from the Canary Islands.

In other words, in this route, the Commission was obliged to intervene by modifying Telefónica's Reference Offer, given the situation detected in the retail markets in the Canary Islands and the existing competition problems at a wholesale level for alternative operators.[20]

In the same terms, other underwater trunk line routes have been identified which, as is the case with the Canary Islands, are not developing towards effective competition. As explained in the following sections, there is the real possibility in some routes that an

[20] Regarding this, Resolution 27 dated March 2008 can be consulted which puts an end to the previous information period regarding supply conditions of the existing underwater cables between the Mainland and the Canary Islands and the move is made towards to initiation of a modification process of the reference offer for Telefónica's leased trunk lines (MTZ 2008/5).

operator with significant market power implements different anticompetitive strategies, aimed at denying access (either directly or “constructively” via non-equitable prices or quality discrimination) or horizontally extending their dominant position (for example via making exorbitant packages between commercial wholesale services and regulated services).

The strategy of the operator with significant market power could also be oriented so that they can prevent the appearance of wholesale operators in certain routes, via the erection of artificial entry barriers in the reference market.

Given these elements, it is considered that the level of regulatory intervention needed in the current market should be suitably exhaustive to prevent the reproduction of the behaviours considered here. To this effect, together with access obligations, another series of measures are necessary, such as the publication of a reference offer or access price controls which demand permanent monitoring and currently make the viability of *ex post* intervention difficult.

Degree of difficulty for correcting non-competitive behaviour

As mentioned, Telefónica has a very high market share in the underwater routes which are subject to regulation, at times reaching 100%. The check that can call for *ex post* intervention to be carried out to detect and test certain behaviours, such as unjustified requirements or the application of non-equitable prices[21] does not have the level of intensity and immediateness necessary for avoiding negative effects in the market. In particular, as detailed, the range of practices in which an operator with significant market power could involve itself is too wide to be able to assume that *ex post* intervention could result sufficiently effective. In fact, together with negative access issues, an operator with significant market power could carry out “constructive” negative supply, including the imposition of non-equitable prices (given the absence of an obligation of preventative price control due to the lack of *ex ante* control), fixing of disproportionate conditions for contracting a service, or discriminatory practices.

Possibility that non-competitive behaviour causes irreparable damage to the related markets

Highly related to the previous situation, immediate action is particularly relevant in the reference market with the aim of avoiding any damage to the competition which is difficult to recover. In particular, it is important to highlight that an operator with significant market power, as they are vertically integrated, will also be present in many of the retail services on which the actual trunk network will affect. Any exclusionary behaviour will therefore not only have effects on the reference market, but also on the retail markets that make use of the wholesale services as mentioned in this document.

Conclusion

It is considered that *ex post* intervention is not sufficient for solving market failures that may arise in the reference market.

[21] ERG Report on Guidance on the application of the three criteria test. Page 14: “In the assessment of excessive pricing scenarios arising in a context of single firm dominance, competition law may in certain instances be insufficient, due to the difficulties in the detection and proof of such conduct”.

With all the preceding information, this Commission concludes that it meets the third criterion of considering whether a market is susceptible to *ex ante* regulation.

II.2.2.4 Conclusions regarding meeting the three criteria fixed in the European Commission Market Recommendation

The three criteria are met in the rented trunk lines that cover the following routes:

- Mainland – Ceuta
- Mainland – Melilla
- Mainland – Canarias
- Tenerife – La Gomera
- Tenerife – La Palma
- La Gomera – El Hierro
- Gran Canaria – Fuerteventura
- Gran Canaria – Lanzarote
- Ibiza – Formentera
- Majorca – Menorca

On the other hand, the second criterion is not met in the trunk line markets that cover the following routes, and it is considered that they tend towards effective competition:

- Mainland – Balearics
- Majorca – Ibiza
- Gran Canaria – Tenerife

It should be highlighted that the CNC shares the conclusions of the analysis carried out. In particular for the mainland-Balearics, Majorca–Ibiza and the Gran Canaria–Tenerife routes the CNC believes that it has confirmed the existence of effective competition based on the presence of alternative operators other than Telefónica and the prices of these routes have decreased. The CNC notes that different potential competition problems could exist derived from situation of duopoly. Nevertheless, the limited number of routes and agents involved allows for the consideration that there is sufficiency in the application of competition legislation for these sections of the market.

II.3 Proposal of suppression of existing obligations in the wholesale terrestrial trunk lines and underwater routes that do not meet the three criteria

In accordance with article 10.1 of the LGTel, *"The Telecommunication Market Commission, keeping in mind European Commission Guidelines for market analysis and identification of operators with significant market power, as well as the Recommendations of Relevant Markets, it will define, via a resolution published in the Spanish Official Journal, the reference markets relating to networks and electronic communication services, among which the corresponding wholesale and retail reference markets will be included and their geographic field, characteristics of which can be justified by the imposition of specific obligations".*[22]

In this current document, this Commission has proceeded to define the market rented of terrestrial lines and analyse whether it can be the subject of *ex ante* regulation, in accordance with what is laid out in the Framework Directive in article 10 of the LGTel.

[22] Also see article 2.1 of the Market Regulations.

In line with the conclusions reached by the European Commission in their 2007 Market Recommendation, this Commission considers the reference market not to be susceptible to *ex ante* regulation as it does not satisfy the three accumulative criteria required by the community provisions to be able to proceed to market regulation. From the analysis carried out, a conclusion can be drawn as to the convenience of proceeding with lifting the previously imposed conditions from Telefónica in virtue of Annex 2 of this Commission's Resolution dated 23 November 2006 in which it approves the market definition and analysis of the rented trunk lines, the designation of operators with significant market power and the imposition of specific obligations. Lifting these conditions exclusively affects the following:

- Rented terrestrial trunk lines
- Rented trunk lines that cover the following routes:
    - Mainland – Balearics
    - Majorca – Ibiza
    - Gran Canaria – Tenerife

Therefore, in accordance with the LGTel and the Market Regulation, this Commission considers that it is advisable to proceed to the suppression of the obligations previously imposed on Telefónica. To this effect, it is necessary to keep in mind that there are other operators who are currently using the rented trunk lines in their old routes. Therefore a time period of 6 months is put in place from the publication of the definitive Resolution in the Spanish Official Journal regarding the lifting of the current obligations and is considered reasonable as it ensures the existence of a suitable timeframe for freely negotiating with Telefónica regarding the market conditions or preparing alternative solutions with Telefónica or other operators.

In any case, it may happen that once the market is approved, new circumstances arise in one of the previous routes which may substantially alter the conclusions reached. For example, it could be shown that for a particular terrestrial route there is an absence of alternatives or one of the competitors could disappear from the underwater routes. In this case, the CMT could carry out the three criteria test again for these routes, and if the criteria are met, relevant market analysis could be carried out.

II.4 Analysis of the structure of the wholesale underwater line markets in the routes that meet the three criteria, assessment of the existence of effective competition in these markets and determination of operators with SMP

II.4.1 Description of the market structure and analysis of effective competition in the market

The previous section concluded that there are ten underwater routes that meet the three criteria. At the same time as carrying out the test, the market structure has been determined and the analysis has enabled assessment of the level of existing competition. The conclusions that have been drawn for each one of the ten routes are practically identical:

- Telefónica is the only operator that has infrastructure on these routes. Abertis only supplies low capacity circuits on the Majorca–Menorca routs via radio-links which do not pose any real competition to Telefónica.

- There are significant structural market entry barriers. The initial investment required for underwater cable is particularly significant. Additionally, Telefónica's retail market shares in the territories that depend on underwater cable from the incumbent operator are very high, meaning that the economies of scale and scope that they enjoy give them a very relevant competitive advantage.
- The size of each one of these markets is reduced. There are no alternative infrastructures in place or loop unbundling in the territories connected by these routes.

This said, and keeping in mind the previous conclusions, this Commission considers that there is no effective competition in any of the ten reference markets, with regards to what is laid out in the Framework Directive, in other words, when the presence of an operator with significant market power is noted.

II.5 Proposal for identification of operators with significant market power

In accordance with the conclusions in the previous section, it is proposed that Telefónica be an operator with significant market power in the ten markets of rented trunk lines that have passed the three criteria test, for the purposes of article 10.3 of LGTel and 3.2 of the Market Regulation. It is understood that this identification of Telefónica's market position extends to the companies of the group to which it belongs and that supply the services included in the reference market.[23]
On the other hand, identifying the significant market power responds to the objective of *ex ante* regulation, stated in section 16 of the Guidelines, which is to ensure that the company may not use its market power to restrict or distort competition on the relevant market, nor may leverage market power onto adjacent markets.

II.6 Analysis of the obligations susceptible to being imposed on operators with significant market power

II.6.1 Principles to be applied by the regulator when choosing the most suitable obligations

When deciding which obligations should be imposed on the operators with significant market power in a particular market, the regulations establish a series of principals that should guide the National Regulatory Authorities (hereinafter, NRAs) in the selection of the obligations. In this sense, the NRA must take reasoned, transparent decisions that respect the principles of proportionality and which are in line with the objectives set out in the Framework Directive, by choosing the least burdensome obligation and taking into account its effect on connected markets.

In fact, article 10.4 of LGTel (drawing on article 8 of the Framework Agreement) establishes that obligations must be based on the nature and proportion of the problem that is detected and be justified according to the objects listed in article 3 of LGTel. Amongst others, these objectives are:

[23] This Commission has already spoken out with regards the concept of economic unity, interpreting reiterated community jurisprudence (see Resolutions dated 20 May 1999 and 8 November 2000) which state that *"when a group of societies make up an economic unit, even if they lack the necessary behavioural autonomy in the market with regards the matrix society, there is only one company that can apply the dispositions of competition law"*.

- Promote competition in the supply of electronic communication networks, electronic communication services and resources and associated services, amongst others:
    a) By ensuring that there is no falsification or restriction of the competition in the electronic communications sector;
    b) By promoting efficient investment in infrastructure materials and promoting innovation; and
    c) By promoting the efficient use and watching out for effective management of the radiofrequencies and the numbering resources
- Contribute to the development of the interior market, amongst other things:
    a) By transparent, mutual cooperation and cooperating with the Commission to guarantee the development of coherent regulatory practices and a coherent application of the Framework Directive and the specific directives.

Likewise, the NRAs have to preferably impose obligations with effect in the wholesale markets and only when these measures do not guarantee effective competition in the reference market will they be imposed on the retail markets as established in the Explanatory Note in the Recommendation.[24]

Together with these explicit principals from the current regulations, there are others which branch off them, although not explicitly stated, as laid out in the *ERG Common position on the approach to appropriate remedies in the new regulatory framework* document[25] (hereinafter, the Common Position). In fact, the NRAs must take the following ideas into account when choosing the obligations to impose on SMP operators:

- For those cases in which competition based on infrastructures is unlikely due to the persistent presence of significant economies of scale or scope and other entry restrictions, the NRAs must ensure sufficient access to wholesale inputs.
- For those cases in which duplicating the incumbent operator's infrastructure seems viable, the obligations should generate incentives that are present during the transition process to a market with sustainable competition.
- Obligations must be chosen in such a way that, for the regulated party, the benefits of compliance outweigh the benefits of non-compliance.

Lastly, the recommendations in the *"ERG Common Position on best practice in remedies imposed as a consequence of a position of significant market power in the relevant markets for wholesale rented lines[26]"* (herein, the Common Position of Rented Lines) should be taken into consideration. In this document the ERG provides

24 Page 13; *"A downstream market should only be subject to direct regulation if competition on that market still exhibits SMP in the presence of wholesale regulation on the related upstream market(s)"*. http://ec.europa.eu/information_society/policy/ecomm/doc/library/proposals/sec2007_1483_final.pdf

25 ERG Common Position on the Approach to Appropriate Remedies in the New Regulatory Framework, approved in the PLenary Session ERG 8, of 1 April 2003 and revised in May 2006 (ERG (06) 33 Revised ERG Common Position on the approach to appropriate remedies in the ECNS regulatory framework). http://www.erg.eu.int/doc/meeting/erg_06_33_remedies_common_position_june_06.pdf

26 ERG 07 (54), available at http://www.erg.eu.int/doc/publications/erg_07_54_wll_cp_final_080331.pdf

additional orientation to the NRAs in the imposition of obligations on operators designated as having significant market power in the wholesale rented lines markets.

II.6.2 Identification of competition problems in the reference and related markets

In the first revision of the trunk markets a series of potential competition problems that could emerge in the absence of regulation were identified. Although the identified problems all refer to the trunk routes, the problems that could arise now in the ten routes subject to regulation are similar:

1. Vertical extension of the dominant position: this group of problems appears when a company controls and input that they consider essential for providing a retail service in a competitive market. The vertical extension of the dominant position gives rise to restriction competition in the downstream retail markets where the operators with significant market power also supplies services.

   The types of problems that tend to arise in the reference market are as follows:

   - Refusing service or access;
   - Excessive requirements;
   - Dilatory tactics
   - Price discrimination

   On the other hand, other types of anticompetitive behaviour can also be implemented related to the imposition of unfair pricing by the operator with significant market power, forming a “constructive” negative for supply/access.

2. Horizontal extension of the dominant position: these competition problems arise when a company that is considered dominant in a market uses their financial strength to extend their power into markets that are closely related within the same level of the production or distribution chain.

   In relation to the reference market, the main competition problem that can arise is exorbitant packaging. In this regard, Telefónica’s incentives for packaging commercial wholesale services with regulated services stand out here, in such a way that if an operator wants to take up a commercial offer for some type of service they must contract all their services under the same commercial conditions, unless part of them can be contracted under regulated conditions.

3. Unfair pricing

   Excessive prices: Prices for the rented trunk lines can act as an entry carried to the associated retail markets. In fact, for example, in the case of the mainland-Canary Island route, where it was concluded that the prices imposed by Telefónica were excessive, the broadband retail offers from alternative operators were of a lesser quality than those on the mainland. Therefore, the LLU operators had to immediately stop supplying direct services to the Canary Islands. Therefore, ONO (present in the islands since the beginning of the liberalisation) was forced to offer retail services of a lower quality than on the mainland as their margins were stretched by the trunk prices. It is known that in an extreme case a suitably high enough price can in fact imply access denial.

Other unfair price practises: Previously the possibility was put forward that an operator could lay an alternative cable, in particular in the mainland-Canary Islands route. Paradoxically, once and alternative operator decides to enter the market, Telefónica could have an incentive for reducing prices to a level that that the cable-laying operator could not meet, leaving them without clients or income, thereby forcing them to leave the market. Once the competitor was removed from the trunk route Telefónica could increase their prices and stretch the margins of the operators in competition with them in the retail markets. Given this potential competition problem, it is necessary to ensure that the prices fixed by Telefónica do not impose an entry barrier which would discourage the appearance of infrastructures at least until the entering operator had a critical mass that could reduce their average supply costs.

This said, it should be noted that to date, Telefónica has not carried out this practise in the underwater route with alterative operators. In any case, even the theoretical possibility of the practise has very damaging effects as it can discourage market entry.

II.6.3 Obligations to impose

Potential anti-competitive problems have been detected in the reference market which suggests the vertical and horizontal extension of its dominant position. The problems explained in the previous section are considered to be potential problems due to the existing regulations. In the absence of regulations, these problems could become real. In relation to negative supply, to solve this problem it would be necessary to:

(i) Ensure access to the associated resources;

(ii) Fix a suitable price of the resource used.

II.6.3.1 Access obligations

Point (i) could be solved via the application of article 10 of the Market Regulations (article12 of the Access Directive) where it is established that the States will check that all the reasonable access applications to specific components of the networks and resources associated with the operators with significant market power are suitable and relative to their usage. It should be further noted that this Commission has already imposed the access obligation on Telefónica regarding access to the rented trunk lines in the first round of the markets.

II.6.3.1.1 Speeds on offer

Each one of the routes analysed has different characteristics with regards potential demand, very related with the size of the population in each area. Therefore, each route also has different capacity requirements. The CMT believes that there should be a certain level of flexibility when imposing on Telefónica the obligation to supply a specific speed. Therefore, the CMT must include new speeds in the reference offer if they are deemed necessary.

In any case, Telefónica must continue to supply the speeds that the currently offer, namely circuits up to 622Mbit/s in the mainland-Canary Islands route and up to 155Mbit/s in all other routes.

The CNC considers the measures proposed by the CMT to be generally appropriate. Nevertheless, the CNC shows a certain contradiction in relation to the speeds on offer as the CMT recognise that each route has specific speed requirements; however in the Annex of obligations they extend the requirements imposed for the mainland-Canary Islands routes onto all the routes, which is the obligation of supplying lines up to 622Mbit/s.

The CMT agrees with the CNC and has modified the file to avoid confusion.
Additionally, the CNC, Orange and ONO proposed to the CMT that for certain routes they expressly anticipate the supply of higher speeds such as Gigabit Ethernet and/or STM-64. ONO specified that included in the obligations for operators with significant market power should be the obligation to offer Gigabit Ethernet options in the regulated routes when the alternative operator has Ethernet technology in those routes.
As has been said earlier, the possibility of offering superior speeds in the different routes will be analysed in the next modification process of the reference offer for trunk circuits.

Lastly, the CNC suggests an assessment of the possible obligation of an access offer to wave lengths of 10Gbit/s (also known as lambdas)[27] and dark fibre (in particular is the CMT opts of defining a separate market of dark fibre and they analysis it specifically) in certain underwater routes.

This Commission does consider imposing Telefónica to offer dark fibre or multiplexing by wavelength to third parties in their underwater cabling, keeping in mind the number of fibres and capacity available per cable. To illustrate this, the fibre pairs and the existing available capacity in the cables of some of the routes are shown.

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II.6.3.1.2 Migrations between different types of lines

In accordance with the Common Position of rented lines, the operator with significant market power should facilitate the process of migration of regulated rented lines.

Therefore, Telefónica should facilitate the migration of the regulated conditions of the lines that cover the ten routes that are subject to regulation. Only where physical modifications are necessary for reasons that are sufficiently justified by Telefónica will Telefónica be able to recoup only the incremental costs caused by said modifications from the operator requesting the migration.

[27] Traditionally the Greek letter lambda has been used as a symbol for wave length, therefore, it does not seem suitable, as it does not have a physical sense, to talk of lambdas of 10Gbit/s given that *bits* are not a frequency. Nevertheless, we must understand that the CNC refers to the possibility of offering carrying frequencies of wave lengths to the order of hundreds of nanometres, susceptible to being multiplexed in the same fibre offering each one of them channels with capacity in the order of 10Gbit/s

Therefore, the trunk lines that Telefónica is currently supplying in the regulated routes should be migrated to the conditions established in the current Resolution without incurring any costs, except where physical modifications to the circuit are considered absolutely necessary.

II.6.3.2 Price obligations and associated obligations

Point (ii) implies fixing a suitable access price as Telefónica can have incentives to fix excessive or discriminatory prices for competitors with the aim of closing retail markets. In this case, with the aim of encouraging investment in alternative infrastructure, it does not seem suitable to impose the obligation of offering cost-oriented prices.

New additional underwater cabling would seem improbable if prices are oriented to Telefónica's costs. Therefore, it is preferable to impose reasonable price obligations (article 13 of the Access Directive). The CMT can value the specific characteristics of each one of the routes and avail of the required flexibility at the time of fixing the prices.

To fix the prices the CMT will have to keep in mind, as well as other references, the existing prices in comparable competitive markets, the level of prices that allow access to an efficient operator into the related retail markets and the cost that an efficient operator would face for rolling out an alternative infrastructure in a wholesale route.

On the other hand, Telefónica cannot apply prices that impose an entry barrier that discourages the appearance of alternative infrastructures (i.e. other underwater cabling), at least until the entering operator has a critical mass that will reduce their average supply costs.

Telefónica must count on prior authorisation from CMT to carry out any price modification.

Lastly, Telefónica cannot adopt anti-competitive behaviours such as (and this list is not exhaustive): the imposition of exorbitant contractual clauses (loyalty clauses, exclusivity, right of pre-emption), exorbitant or unjustified packaging (imposition of non-required services, exorbitant package prices), etc.

The applicable prices are as follows:

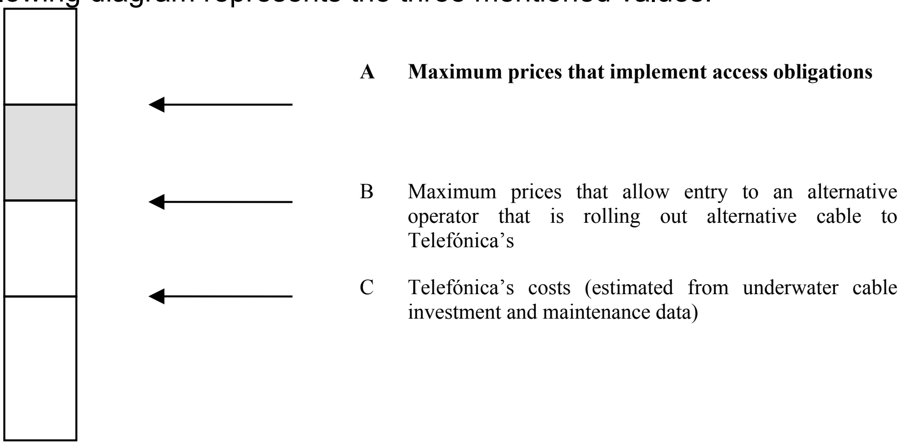
- For the Mainland-Canary Islands route the prices applied will be those established in the Resolution of 10 September 2008 regarding the modification of the trunk offer regarding the Mainland – Canary Islands route.
- For the rest of the routes, Telefónica must present a price proposal in a time frame of a month from approval of the current Resolution. The CMT will assess whether the proposed prices are reasonable and if necessary it can dictate the Resolutions, and thereby modify the prices.

In relation to this obligation, the European Commission "*invites the CMT to provide a detailed definition of the methodology used for fixing the access prices imposed on each route, including the criteria for assessing whether the access prices applied by Telefónica are reasonable".*

It should be pointed out that the CMT will fix the prices on the rest of the routes following the same methodology as in the Resolution of 10 September. In this sense, for the fixing of trunk prices for the mainland–Canary Islands route, the maximum price is determined that will allow an alternative operator to supply broadband services in the Canary Islands via the opening of LLU exchanges using a higher capacity trunk circuit (STM-4, of 622Mbit/s), keeping in mind the current broadband speed distribution and a forecast of the development of said speeds.[28] The maximum prices of the trunk lines are fixed which make effective the access obligation to: higher prices, alternative operators do not find it economically unviable to contract trunk lines on the mainland–Canary Islands routes for opening LLU exchanges in the Canary Islands.

Likewise, another two reference values were calculated: Telefónica's costs and the maximum price of the circuits that allow entry to an alternative operator that rolls-out an alternative underwater cable to Telefónica's. Also, international comparisons were carried out.

The following diagram represents the three mentioned values:



Therefore, the CMT will calculate values A, B and C for all the regulated routes. In general, prices are situated in a range between A and B.

Certainly, in the smaller routes the CMT can arrive at the conclusion that the roll-out of an underwater cable is not feasible for an alternative operator. It is also possible to roll-out underwater cable thanks to public help in some routes.[29] In these cases, the prices could be fixed on an ad hoc basis, keeping in mind the specific characteristics of the route.

Lastly, and in accordance with the comments from the European Commission, the CMT will closely follow the development of the financial conditions for the operation of each route and it will assess whether the current hypothesis continue to be valid during the present period of the current market review.

[28] The prices for the rest of the speeds (2, 34 and 155Mbit/s) are set from the results obtained for the STM-4, keeping tariff consistency between the different speeds

[29] For example, the Government of the Autonomous City of Melilla is analysing the installation of a second optical fibre cable between the Mainland and Melilla (http://www.elfaroceutamelilla.es/content/view/11440/73/

II.6.3.3 Non-discriminatory Obligation

Additionally, the problems that may arise regarding the use of different exorbitant practices (such as dilatory tactics, unjustified requirements, quality discrimination and product packing) on the part of Telefónica, and their effects on other operators, have been described. Therefore, the effectiveness of the access obligation should be ensured, as in the first round, via the additional imposition of the non-discriminatory obligation (article 8 of the Regulation; article 10 of the Access Directive).

This obligation involves applying the same conditions in similar circumstances to the operators that provide equivalent services, and providing services and information to third parties that is of the same quality as that which they supply in their own services or to their affiliates. In particular, non-discrimination should refer both to the quality of the service and to service delivery time-frames and other supply conditions.

II.6.3.4 Obligation of transparency

On the other hand, problems have been listed such as dilatory tactics by Telefónica in the service supply. For the purposes of quickly negotiating between these operators and Telefónica, it is necessary to maintain the obligation of transparency (article 7 of the Market Regulations; article 9 of the Access Directive) which is set in the maintenance of a suitably broken-down reference offer so as to guarantee that other operators are not asked to pay for resources that are unnecessary for the required service.

The prices included in the offer are fixed. Therefore, if Telefónica wants to modify them, they must communicate their price proposal to the CMT. If the CMT authorises the prices, they must include them in the offer and, in accordance with the non-discriminatory obligation, they must be the same for all operators.

The points laid out in the previous paragraph are applied in the case of offering new speeds into the offer, independently of the technology that supports the capacity offered on the route.

III SUMMARY OF MODIFICATIONS

Lastly, in this chapter, the most relevant new innovations are presented with regards the market analysis carried out in the first round:

- Declare effective competition and abolish all the obligations imposed on Telefónica in a timeframe of six months in the wholesale markets for rented trunk lines, except in the following ten routes:
    - Mainland – Ceuta
    - Mainland – Melilla
    - Mainland – Canary Islands
    - Mainland – La Gomera
    - Tenerife – La Palma
    - La Gomera – El Hierro
    - Gran Canaria – Fuerteventura
    - Gran Canaria – Lanzarote
    - Majorca – Menorca
    - Ibiza – Formentera

- In the previous ten routes the obligations established in the first round are maintained, with the following additions:
    - The prices must be reasonable. In no cases can the prices offered to third parties by the operators declared to have significant market power be excessive nor entail a compression of operative margins for the applicant operator that impedes market entry for an efficient operator, both in the related retail markets and in the actual wholesale market.
    - The transparency and non-discriminatory obligations have been amplified and made clearer with the aim of detecting and avoiding anti-competitive practices by Telefónica.
    - The technical condition approved in the Canary Islands' RLO will be applied to the rest of the routes.
    - The prices regulated by the Canary Islands RLO will be maintained. For the rest of the routes Telefónica must sent a proposal in one month from market approval, showing that said prices can be revised in the next modification of the trunk Reference Offer.

Fourth. Notification and publication of the Measure

According to the provisions of article 7.5 of the Framework Directive and article 5.4 of the Market Regulation, the Comisión del Mercado de las Telecomunicaciones will, insofar as is possible, take the remarks made by the European Commission and by the National Regulatory Authorities into account, and may adopt the resulting draft measure, in which case, it will inform the European Commission.

For its part, article 10.1 of the LGTel establishes that the Comisión del Mercado de las Telecomunicaciones will define *"by means of a Resolution published in the Spanish Official Journal the reference markets relating to networks and networks electronic communications services (…) and the geographic zones of same, whose characteristics may justify imposing specific obligations".*

By virtue of the *de facto* and *de jure* considerations set forth, this Comisión del Mercado de las Telecomunicaciones

HAS DECIDED

First. To approve the definition and analysis of the markets of call termination in the individual public networks of each fixed telephone operator, to designate an operator with significant market power and to enforce specific obligations, as stated in the Third section of Legal Basis of this Resolution.

Second. To consider that the:

- Rented, terrestrial route, trunk line markets

- Rented underwater lines covering the following routes
  - Mainland – Balearics
  - Majorca – Ibiza
  - Gran Canaria – Tenerife

are not market whose characteristic justify the imposition of specific obligations and are therefore not susceptible to *ex ante* regulations, in accordance with the Framework Directive and article 10 of the General Telecommunications Law.

Third. Lift Telefónica de España, SAU's obligations currently applied to the them for the routes established in the second Resolution, in virtue of the Resolution of this Commission dated 23 November 2006, which approve the market analysis and definition of trunk segments of wholesale rented lines, to designate an operator with significant market power and to enforce specific obligations, once a period of six months has passed from the publication of the Resolution in the Spanish Official Journal.

Fourth. Consider the market of rented trunk lines that cover the following routes
- Mainland – Ceuta
- Mainland – Melilla
- Mainland – Canary Islands
- Tenerife – La Gomera
- Tenerife – La Palma
- La Gomera – El Hierro
- Gran Canaria – Fuerteventura
- Gran Canaria – Lanzarote
- Majorca – Menorca
- Ibiza – Formentera

As reference markets that could be subject to *ex ante* regulation in accordance with the Framework Directive and article 10 of the General Telecommunications Law.

Fifth. To determine that the abovementioned reference markets are not really competitive, in the sense of the provisions of section 4, article 16, of the abovementioned Framework Directive and section 3 of article 10 of the General Telecommunications Law.

Sixth. To consider that the companies listed in Annex 1 to this Resolution, in the terms of section III of the Third section of Legal Basis, have significant market power in these reference markets, in the sense of the provisions of section 2, article 14 of the Framework Directive, and in Annex II, section 8 of the General Telecommunications Law.

Seventh. To impose on Telefónica de España, S.A.U. the obligations from Annex 1 of the current Resolution.

Eighth. To inform the European Commission of the definition and analysis of the markets of trunk segments of the wholesale rented lines, to designate an operator with significant market power and to enforce specific obligations.

Ninth. To agree upon publishing this deed in the Spanish Official Journal, in accordance with the provisions of article 10.1 of Law 32/2003, dated 3 November, the General Telecommunications Law.

Tenth. The present Resolution will be effective on the day after its publication in the Spanish Official Journal.

This certificate is issued under the provisions of article 27.5 of Law 30/1992, dated 26 November, and article 23.2 of the Consolidated Version of the Internal System Regulations approved by the Commission Board Resolution of 20 December 2007 (Spanish Official Journal of 31 January 2008), prior to the approval of the Act of the corresponding session.

Furthermore, it is hereby stated that a voluntary appeal for review may be lodged against this deed with this Commission within one month from the day following its notification or, directly, an Administrative-Contentious appeal before the Administrative-Contentious Division of the Spanish National Court, within two months as of the day following its notification, in accordance with the provisions of article 48.17 of Law 32/2003, dated 3 November, the General Telecommunications Law, the fourth additional Disposition, paragraph 5, of Law 29/1998, of 13 July, governing the Administrative-Contentious Jurisdiction, and Article 116 of Law 30/1992 of 26 November, of Legal Regime of Public Administration and of Common Administrative Procedure, and without prejudice to the provisions of number 2 of Article 58 of the same Law.

The present document bears the electronic signature of Secretary Ignacio Redondo Andreu, with the approval of the President, Reinaldo Rodríguez Illera.

ANNEX 1: MEASURES TO BE IMPLEMENTED IN THE WHOLESALE MARKETS OF LEASED TRUNK LINES SUBJECT TO EX ANTE REGULATION

1.- Obligation to supply wholesale services of leased trunk lines to all operators at regulated prices

The effectiveness of this obligation requires the generic implementation of the following obligations on Telefónica:

a) Meet the reasonable applications for access to specific resources in their networks and usage (articles 13.1 d) of LGTel and 10 of Market Regulations; article 12 of the Access Directive)

This obligation implies, amongst other things that Telefónica is obliged to:

- Provide third party access to specific components and resources from their network that are necessary for the supply of wholesale trunk line services. In particular, Telefónica must supply the following services to third parties:
    - Transport service: Service by which Telefónica supplies the section of the circuit between two of their front exchanges situated at the ends;
    - Connection service: Service in which Telefónica offers the connection to their network via the supply of portable capacity between the Telefónica interconnection circuit exchange and the interconnection point of the circuits situated in operator's front exchange, as long as the distance between both is less than 30km.
    - Any other facility associated with the aforementioned points that are necessary for the supply of wholesale reference services.
- Negotiate in good faith with the authorised access applicants
- Grant free access to technical interfaces or other technologies that are indispensable for the inter-operability of the services
- Keep access to facilities that are currently being supplied without previous approval from the CMT
- Provide third party access to the operative support systems or information technology systems with similar functions.

Telefónica will keep its configurations in the Circuit Interconnection Points (known as PdICs) as laid out in the current Canary Islands' RLO, as well as all the forecast possibilities regarding the reuse of infrastructures.

In summary, the previsions contained in the Canary Islands' RLO remain effective, approved via CMT Resolution dated 10th September 2008. The technical conditions laid out in the offer will be applied for all the regulated routes.

With regards speed, Telefónica must supply circuits of up to 622 Mbit/s in the Mainland-Canary Island route and up to 155 Mbit/s in the rest of the routes. In any case, the CMT can introduce new speeds in the offer in any of the routes if they consider it necessary.

The aforementioned points, do not affect the competency of the CMT for introducing changes in the reference offer, in accordance with article 9.2 of the Access Directive and in article 7.3 of the Market Regulations.

Telefónica must facilitate the process of migration to the regulated services of leased trunk lines. In the case that physical modifications are necessary for reasons that are sufficiently justified by Telefónica, Telefónica will be able to recoup only the incremental costs caused by said modifications from the operator requesting the migration.

b) <u>Offer reasonable prices for the supply of access service (articles 13.1 e) of the LGTel and 11 of the Access Regulations; article 13 of the Access Directive)</u>

In no case can the prices offered to third parties by the operators declared to have significant market power be excessive nor create entry barriers that impede market entry for an efficient operator, both in the related retail markets and in the actual wholesale market.

Amongst other references, the CMT will keep in mind the existing prices in the comparable competitive markets, the level of prices that allow entry for an efficient operator into the related retail markets and the costs an operator would face for roll-out of infrastructures that are alternative to the wholesale route.

Telefónica must count on the prior authorisations from the CMT for carrying out any price modification.

Lastly, Telefónica cannot adopt anti-competitive behaviour such as (and this list is not exhaustive): the imposition of exorbitant contractual clauses (loyalty clauses, exclusivity, right of first refusal), exorbitant or unjustified packaging (imposition of non-required services, exorbitant package prices), etc.

2.- Non-discriminatory obligation in the conditions of the wholesale services of leased trunk lines (articles 13.1 b) from the LGTel and 8 from the Market Regulations; article 10 of the Access Directive)

Article 10 of the Access Directive details the scope of the application of this principal in the following terms: *"the operator applies equivalent conditions under similar conditions to other companies that supply similar services and supply services and information to third parties of the same quality as that which they supply for their own services or those of their affiliates under the same conditions".*

Therefore, Telefónica will implement the necessary measures for the supply of leased trunk lines, supplying equivalent resources to third parties as those which they supply to themselves or to their affiliated companies, in the same conditions and timeframes.

For the purpose of controlling the compliance of this obligation:

- The agreements that Telefónica subscribes to the rest of the operators, to its affiliates and with other companies in the Telefónica Group, must be formalised in writing and be communicated by Telefónica to the CMT in a maximum time period of 10 days after them being drawn up.

- Telefónica will be obliged to inform the CMT of certain parameters regarding the supply of the wholesale services of leased trunk lines, with the aim of supervising the correct compliance of the non-discriminatory obligations. For example, they would extend the quality obligations relating to the service of leased trunk lines that Telefónica currently have imposed to all the regulated routes, in application of the current Canary Islands' RLO, approved via CMT Resolution dated 10th September 2008.

  The aforementioned points, do not affect the competency of the CMT for introducing changes in the reference offer, in accordance with article 9.2 of the Access Directive and in article 7.3 of the Market Regulations.

3.- Transparency Obligation in the supply of the wholesale services of leased trunk lines

a) <u>Telefónica is obliged to publish a sufficiently broken down Reference Offer for the supply of wholesale leased trunk line services in order to guarantee that unnecessary resources for the required service do not have to be paid</u>

(articles 13.1a) of the LGTel and 7 of the Market Regulations; article 9 of the Access Directive).

This reference offer should include, at least, the following components as they are currently defined:

- Localisation and description of the exchanges where the access is offered.
- The services of service modes of access that are on offer. Where necessary, the applicable technical or financial details will be noted that are applicable to each one of the services/modes and an exhaustive description of the functional capacities included in each service or mode of access service will be given
- The required technical characteristics for the networks or specific components that are used for the connection to the points in which access is offered, will, where necessary, include information relating to the supply conditions of these specific networks or components
- The technical specifications of the interfaces offered in the network terminations points, where necessary, will include the physical and electrical characteristics and the functional capacities offered via the interface.
- The processes and conditions for access to information for supply of services and the relevant operation systems.
- The general conditions for carrying out and maintaining access, in particular, those relating to the methods and phases of the tests for verification and processes for proceeding to updates or modifications in the access points where there is no modification in the offer.
- The service level agreements
- The financial conditions, including the prices applicable to each one of the offer components

For the purposes of this obligation, for the leased trunk lines between the Mainland and the Canary Islands the current Reference Offer is considered to be effective. The last modification of this offer was approved via CMT Resolution on the 10th September 2008 and remains current.

In one month from the adoption of the current measure, Telefónica will include the specific conditions in the previous offer (in particular, the price proposal), for leased trunk lines that cover the rest of the routes. This offer will be communicated to the CMT and the operators.

The aforementioned points, do not affect the competency of the CMT for introducing changes in the reference offer, in accordance with article 9.2 of the Access Directive and in article 7.3 of the Market Regulations.

In any case, Telefónica must maintain the reference offer up to date and in the case of modifying it, the modification will be considered to come into effect four months after its publication, unless a different time period is stated by this Commission.

The prices included in the offer are fixed. Therefore, if Telefónica wants to modify them, they must communicate their proposal to the CMT. If the CMT authorises the prices, they must include them in the offer and, in accordance with the non-discriminatory obligation, they must be the same for all operators.

The points laid out in the previous paragraph are applied in the case of offering new speeds into the offer, independently of the technology that supports the capacity offered on the route.

4.- Identification of the specific conditions for access to the wholesale services of leased trunk lines

Telefónica and the operator will set the general conditions under which Telefónica will supply the services detailed in section 1. a).

Under article 7.3 of the Market Regulations, the CMT will be aware of the conflicts which, in relation to these accesses, will be set out between the operators, both during negotiations with the operators and whilst carrying out them out. The CMT will decide on the suitability of the access application and, where necessary, it will dictate the agreement conditions for guaranteeing the suitability of access, interconnection and inter-operability of the services, as well as achieving the objectives established in article 3 of the LGTel. In accordance with article 14 of the LGTel the maximum time period for solving said conflicts will be four months.

ANNEX 2: ANALYSIS OF THE TRUNK NETWORK OF TWO ALTERNATIVE OPERATORS

Introduction

This annex describes how the trunk networks of two alternative operators have been constructed. Details are given as to whether dark fibre or leased circuits have been used, or whether the choice was made to construct their own network in the different routes.

[CONFIDENTIAL]

Conclusion

In the two cases analysed, leasing dark fibre from third parties is essential for the construction of trunk networks. Likewise, the little dependency on Telefónica's infrastructures is stated.

ANNEX 3 – SUMMARY OF OPERATOR ALLEGATIONS

I.1 Definition of leased trunk line markets

I.1.1 Summary of allegations

Dark Fibre

ASTEL and Orange believe that the inclusion of dark fibre in the market reference is necessary. ASTEL found a certain contradiction in stating that operators who provide dark fibre are competing with the operators of leased lines, disciplining their behaviour and at the same time excluding dark fibre from the reference market.

In the same line, Telefónica also considers that the leased trunk lines and dark fibre are substitutable both from the point of view of demand (dark fibre represents 80% of the costs of a trunk line) and from the point of view of supply (the suppliers of the fibre only need to notify the CMT at the start of the supply of leased trunk lines). Therefore, Telefónica concludes that dark fibre is included in the reference market. Telefónica points out that the Norwegian regulator expressly includes dark fibre in the trunk market.

Trunk lines for connection of RUO rooms

In Telefónica's opinion, signal delivery via leased lines should not be regulated as in large part, in the exchanges with co-location, the operators use alternative lines to the bearer capacity. Telefónica adds that they only deliver 50% of the IAPs and 30% of the IP-IAPs with leased circuits, which indicates that they do not have significant market power in this segment.

I.1.2 Response to the declarations

Dark Fibre

In relation to ASTEL, Orange and Telefónica's allegations regarding the inclusion of dark fibre, the CMT considers that it has already been justified that the dark fibre is an upstream market in comparison with the leased trunk lines and there is no contradiction in not including it in the market, but it does take into consideration its impact in the market. In fact, the measure in which competition in the market of leased dark fibre is sufficient, the entry barriers to the downstream markets, and the reference markets will be reduced, which will have an impact on the competitive situation. Therefore, the preliminary conclusions drawn are still relevant and the inclusion of dark fibre into the reference market is ruled out.

Trunk lines for connection RUO rooms

The CMT considers circuits for connecting RUO or IAP rooms to be an advantage associated with markets 4 and 5, which means Telefónica must continue to supply the services given its SMP position in said markets. Therefore, Telefónica's allegation is rejected.

I.2 Analysis of the three criteria for underwater trunk lines

I.2.1 First criteria

I.2.1.1 Summary of allegations

Telefónica points out that there are no legal or regulatory barriers. Telefónica also argues that the alternative operators can choose to invest in those areas that are of particular interest and, in particular, in profitable areas in accordance with their socioeconomic factors. They also have alternative options without excessive investment which can lead to the conclusion that there are no structural barriers.

I.2.1.2 Response to the allegations

This Commission agrees with Telefónica regarding the absence of significant legal entry barriers. Nevertheless, as opposed to Telefónica's statements, due to the high initial investment needed to lay underwater cable, the structural entry barriers in this case are essential, in particular the hidden costs and the economies of scale and scope. In this sense, the CMT does not know of alternatives that allow for the underwater roll-out of cable without the need for high investment, as Telefónica states. Therefore, their allegation is rejected.

I.2.2 Second Criteria

I.2.2.1 Summary of allegations

Gran Canaria – Tenerife

Some ASTEL operators feel that effective competition does not take place in the Gran Canaria – Tenerife route, and they propose that this degree of competition in this route is analysed in more depth. Orange argues that ONO is a relevant shareholder or CSC and therefore there is a higher risk of negative access, establishing exorbitant prices and discrimination. Orange adds that as a consequence of the lack of regulation, that route could be a Telefónica-ONO duopoly.

Routes with no alternatives

On the other hand, Telefónica believes that in all the underwater routes, and not only those that the CMT show, there are multiple and different alternatives that allow operators to offer the services that are subject in this market, without the need of using Telefónica's infrastructures.

Telefónica considers that the slightest development of the alternative loop in the Canary Islands is not related with the conditions of this current offer for trunk circuits in this route; and it will only be related to the investment decisions of the operators. Empirical evidence of this are the routes from Portugal to Madeira and the Azores where their regulation by Anacom has not involved more development than the loop offer.

Also, Telefónica thinks that any operator could maximise the overall profitability of their end services in such a way that the price determination for certain routes from the Mainland to the Canary Islands would dilute into the national group.

Telefónica believes that there is sufficient supply in the Canary Islands via underwater cables with international routes that are based in the archipelago. Gran Canaria and Tenerife have SAT-3 and Atlantis 2 respectively, co-participated by BT (with 8.7%) and France Telecom (with 7.9%), both with a higher weighting than Telefónica (1.1%) which concludes that these two operators and any other that arrived at an agreement could avail of sufficient capacity to reach the clients of these islands.

On the other hand, entry into the market of different consortia is predicted in the short term, both in the Canaries (Infinity, Main One) and in the Balearics (Proyecto Rómulo), which will soon be used for the rest of operators for the supply of the reference service. Competitive pressure from new offers is prospectively increased over the length of time covered by the current market analysis stage.

Furthermore, Telefónica argues that operators also have the national indirect access mode to supply broadband services in the archipelago.

For the routes to Ceuta and Melilla, Telefónica believes that the operators could have their contents arrive by satellite via the ASTRA or HISPASAT consortia and use a back-up via a Moroccan operator such as Meditel. Telefónica adds that for the Mainland-Ceuta route it would be viable to develop 155 Mbit/s radio-links.

For the following routes: Tenerife – Gomera, Tenerife – La Palma, Gomera – Hierro and Ibiza – Fomentera, due to the small populations in these territories, it would seem unjustifiable that there were an operator Point of Presence in these islands. Furthermore, except for the Gomera-Hierro route, it is possible to establish radiolinks of up to 155 Mbit/s.

In relation to the Mallorca – Menorca route, Telefónica points out the existence of Albertis' radio-links as an alternative, which means it should not be a route where regulatory obligations are imposed.
For all these reasons, Telefónica confirms that the underwater trunk segment market tends towards effective competition.

I.2.2.2 Response to the declarations

Gran Canaria – Tenerife

As stated by Orange, it is correct that ONO is a shareholder of CSC. If it were the only shareholder or its participation in the cable allowed it absolute control over CSC company decision, Orange's declarations could have a certain weight. However, this is not the case, as SODECAN[30] and various Canary Island Savings banks are shareholders too. These saving banks on one hand are committed to the development of the information society and on the other they have logical interest in maximising the profitability of the investment in CSC. These objectives go against the hypothetical practises that Orange is concerned about, in particular with regards access denial. In

[30] Sociedad para el Desarrollo Empresarial de Canarias, S.A. (S*ociety for Business Development in the Canary Islands*) is a public investment body created in 1976.

any case, given the supposed duopoly situation, Orange must justify the possibilities of group dominance that, where applicable, could mean, according to the Guidelines, that the situation described could not take on the identification of an individual operator with significant market power as Orange seems to suggest.

In conclusion, for the previous reasons, Orange's declaration is rejected.

Routes with no alternatives

Telefónica's allegations regards overall profitability of investments are not acceptable. Telefónica suggests that an operator could invest in the Canary Islands at a loss to then recover costs in the Mainland but this is not a logical option from a financial point of view. Except for the distances, it would be as if Telefónica was deciding to invest in an EU country, knowing that it wasn't profitable but that it could compensate its losses with the profits obtained in the United Kingdom and Spain, for example. Clearly this option does not make any sense, as overall profits will be higher it they weren't to invest in the country in question.

With regards the Mainland – Canary Islands route and the existing underwater cables for supplying services on the route, it continues to be necessary to negotiate with Telefónica for accessing the Canary Islands' cable support frame, so dependency on Telefónica remains. Nevertheless, the CMT has kept in mind the current projects for laying new cables between Europe and West Africa in the modification file for the trunk offer for the Mainland – Canary Islands route, as they represent a huge opportunity for an operator to lay a branch line in the Mainland – Canary Islands route. In fact, the CMT fixed the prices in said file with the intention of not discouraging the entry of a competitor into the route.

This Commission considers that the prospective analysis does not suggest, as Telefónica has said, an analysis of the theoretical possibilities that operators count on to access the market. Therefore, except in the previous case, the CMT has not identified situations that anticipate real access to the market.

With regard to the allegations relating to whether it is possible to supply broadband service in isolated areas via IP-ADSL, the CMT does not consider it to be a sufficient alternative for eliminating the bottle necks that hinder direct investment in the island territories, Ceuta and Melilla. In fact, the possibilities that a leased circuit offer are superior, including the drawing-up of a company's own networks and the supply of additional services that the wholesale services indicated by Telefónica do not allow.

Lastly, the alternative that Telefónica put forward for the routes to the smaller islands and to Ceuta and Melilla are not considered profitable from a technical and economical point of view due to its less capacity in comparison to fibre, and its higher costs that will not allow efficient competition in the retail markets. On the other hand, it seems clear that the underwater cable is doubtlessly the best option, as it is the one that Telefónica uses itself.

Therefore, Telefónica's allegations regarding this point are rejected.

I.2.3 Third Criterion

I.2.3.1 Summary of allegations

Telefónica states that there cannot be competition issues in these routes and it argues that possible negative access could not happen in practise as even where there were no obligations imposed on the operators, there was the general obligation of facilitating inter-operability of services, as laid out in article 4 of the Access Directive.

Furthermore, in the hypothetical case of there being a problem relating to competition, it would not be difficult to detect it as the right to competition would be sufficient to correct it.

I.2.3.2 Response to allegations

With regards the third criterion, it must be noted that as opposed to what happens in the terrestrial routes, in the field of the underwater routes there is currently nor potentially any alternative supply in the current market period that allows for disciplining potential anti-competitive behaviour

In fact, as mentioned, the existence of significant entry barriers limits third party access to the market. In this sense, anticompetitive behaviour such as negative supply or the imposition of excessive pricing, can lead to the closure of the market as an ultimate resort as there are no alternative measures for supply the service, as well as the retail services that depend on the market that is analysed here. Telefónica therefore has large incentives for denying access/supply and has the resource to carry out potential anticompetitive practises. In this way, a preventative and immediate action by the ANR is essential as it will ensure that those operators present in the market are not rejected and at the same time it will guarantee that those that wish to entry can do so under competitive conditions.

As opposed to what Telefónica mention regarding the absence of conflicts in this market, it should be pointed out that given existing competition problems at a wholesale level for alternative operators in relation with the Canary Islands route, this Commission's intervention was required – via the Resolution dated 10th September 2008 – to modify Telefónica's Reference Offer. Therefore Telefónica's declaration cannot be accepted when recently failures in the market have been detected which have require the regulatory intervention of this Commission. Therefore *ex ante* regulation is seen as necessary for the continued vigilance of correct market development.

Furthermore, as shown in the Explanatory Note, *ex ante* regulation should be considered as a necessary complement to the competition law in those cases in which the *ex post* regulation is not sufficient for solving the detected market failures, for example if the necessary regulatory regulations for the competition development cannot in principal be imposed in accordance with competition law. In this respect, access obligations are of particular importance for promoting competition in this market. In this respect, the need to guarantee inter-operability to which Telefónica alludes, is different, and it does not necessarily have a commitment to stability in comparison with the imposition of an operator with significant market power of an obligation of providing access to new clients (and maintaining their offer to existing clients) in accordance with market regulations.

I.3 Proposal for suppression of obligations in the routes that do not comply with the three criteria

I.3.1 Summary of allegations

Telefónica considers that the timeframe for lifting obligations should be reduced to three months, in line with other markets.

I.3.2 Response to the allegations

In response to this declaration, it should be pointed out that the characteristics of this market have make it advisable to have a longer timeframe than that laid out in other markets for lifting obligations, in this case six months, as this timeframe will allow the operators to negotiate alternatives to Telefónica and migrate, where necessary, to a new supplier. This therefore means Telefónica's declaration is rejected.

I.4 Measures to impose on the underwater trunk markets

I.4.1 Summary of declarations

Speeds offer

Telefónica believes that the obligation to offer 622 Mbit/s circuits is unjustified and it disproportionate for the following reasons:

- There is not general demand for circuits of this speed. Currently ONO is the only operator that has circuits of this speed in the Mainland – Canary Islands route.
- Neither Arcep nor Anacom have regulated circuits of more than 155 Mbit/s in the routes with La Reunión and Madeira.
- There are no structural barriers to laying underwater cabling. Regulating underwater cable routes discourages investment

Prices

ASTEL believes that in section 1.b) of Annex 1, the provision should be added for Telefónica to not be able to carry out price reductions that involve reducing of margins as these situations are the ones that create most difficulties for competition in the retail markets.

Telefónica shows that in their network model Ceuta and Melilla are appointed to the provinces of Cádiz and Málaga respectively, in which case the imposition of obligations should be specified for the Cádiz – Ceuta and Málaga – Melilla routes.

The *Govern de les Illes Baleares* alleges that reasonable price obligations imposed on Telefónica in the underwater routes should not exceed 7% of the industrial profit over the cost price. It believes that to avail of current prices Telefónica needs to provide their price proposal at least annually.

Vodafone alleges that in certain regulated routes there are no reasonable prices and instead the prices are excessive, as in the Mainland – Canary Islands route and the Mainland – Melilla route. Vodafone has estimated some maximum prices that could be considered as reasonable on the basis of the following information:

- Actual price references that exist in the current market
- The maximum price that will allow Vodafone to offer competitive retail prices in the Canary Islands and Melilla with the roll-out of the network that allows for the supply of a service of suitable quality
- Public information regarding Telefónica's current cost accounting so that the prices proposed were, in any event, superior.
- Information relating to the roll-out of the network with the aim of incentivising the roll-out of other alternative routes.

Based on this information, Vodafone proposes the following maximum prices:

- Mainland –Canarias route: STM-1 **[CONFIDENCIAL]**
- Mainland –Melilla route: STM-1 **[CONFIDENCIAL]**

On the same line, Orange alleges that the proposal to regulate the 10 underwater routes imposing the obligation of reasonable pricing, taking as an example the prices already approved for the Mainland – Canary Islands route, is insufficient for achieving the aim that alternative operators access connected territories via said routes, encouraging their investment.

According to Orange, neither the capacities nor the regulated prices that do not allow even for planning redundancy, are adequate for encouraging the unbundling of the loop in the Canary Islands as the CMT suggests.

On the other hand, ONO considers the methodology developed by the CMT in the modification file of the RLO regarding the Mainland-Canary Islands route to comply, in general with the reasoning of this Commission that the retail access price that is acceptable or regulated be situated in a range between minimum and maximum values that on one hand allow for replication of the Telefónica's retail offers, and on the other, they leave a margin for the entry of a competitor that wants to lay alternative underwater cable. Therefore it is considered to be accurate that this criterion is applied to the other nine routes that are subject to regulation.

No discrimination

ONO believes that the obligation for presenting the agreement before the CMT should apply only to the operator with significant market power, namely Telefónica as it is the operator that they wish to control the compliance with an obligation of service supply without discrimination.

I.4.2 Response to the Public Consultation allegations

Speeds on offer

It is not true, as Telefónica states, that there is no general demand for STM-4 circuits. The operators are requesting this capacity and in fact, some operators have requested the regulation of higher speeds from the CMT.

It is also incorrect that there are no entry barriers for roll-out of an underwater cable, as has been previously discussed.

Prices

The request from ASTEL regarding the prohibition of tightening of margins is laid out in the paragraph in section1b) of the Annex on obligations.

Telefónica's points regarding the routes to Ceuta and Melilla will be analysed in the modification file of the trunk reference offer.

With regards the different allegations about prices, and in line with ONO's declarations, it should be pointed out that the CMT calculates the prices for the underwater regulated routes following the same methodology as the Mainland – Canary Islands route. In any case, the real possibility that an operator could roll-out an alternative cable in one of the routes is kept in mind.

Non-discrimination

ONO's allegations are accepted and it is established that only Telefónica should be the one to send agreements to the CMT, as they the operator declared as having significant market power in the reference market.

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