

ORDER

Under the terms of that laid down in article 9, nº 3, of Decree-Law nº 283/89, dated August 23rd, and under the terms of articles 137, numbers 2 and 4, and 141 of the Administrative Procedure Code, and article 47 of the Administrative Tribunal Processes Law, the Deliberation made on the 21st of February of this year is hereby ratified on the basis that certain aspects were invalid.

Thus, reference is now made expressly to the reason for the inexistence of any prior audience for interested parties, correcting this situation by providing a detailed explanation for the motive behind the act and taking the opportunity to indicate all the subsequent alterations made to the said deliberation after it had been executed¹.

A. PRIOR AUDIENCES FOR INTERESTED PARTIES

The development of the *Information Society*, with the use of the Internet as its driving force, depends totally on the accelerated growth of Internet use in Portugal. This desideratum was defined as a strategic priority in the government's programme, which invests heavily in the generalization of access to information resources and the transmission of knowledge.

¹ The numbering used in the Deliberation of February 21st has been maintained for ease of comparison.

The Plan of Action drawn up to increase the use of the Internet is based upon the supposition that there will be *a real change in the scale and an unprecedented acceleration in the diffusion of information technology in the Portuguese society. It demands a new partnership between the private and public sectors*, as stated in the Council of Ministers Resolution nº 110/2000. Such demanding objectives as “... *achieve average Internet penetration by 50% of the population in 2003 through the... broadband accesses and flat-rate tariffs available from three competitive resources: cable-modem (cable TV), ADSL, (UMTS) ... Low speed access, either gratuitous or at a symbolic price (citizen’s access)*” are really based on the supposition that suitable steps would be taken with the utmost urgency, even more so because the Internet Initiative represented “*a technological opportunity to make speedy in-depth reforms with a view to seeing our society functioning as a network*”.

It must also be noted that the protocol celebrated between the Internet Service Providers (ISP's) and PT - Comunicações, S.A. that controlled their relationship, expired in December 2000, with both parties unable to reach a new agreement. The ISP's made repeated appeals to the Instituto das Comunicações de Portugal (ICP) to intervene in this material.

So, considering the pressure of taking steps to encourage the use of the Internet and the special obligations of the ICP as regulating organ of the telecommunications sector, this Board of Directors felt that in the light of the urgent nature of the decision in question and under the terms of article 103, nº 1, paragraph a) of the Administrative Procedure Code, there was no place for a prior audience for the interested parties.

B. REASONING AND ALTERATIONS PRIOR TO THE 21ST OF FEBRUARY 2001

1 - TRANSITION TO A SINGLE INTERCONNECTION MODEL

During the preparatory process of the Deliberation of February 21st it was reported that the ISPs in general considered the transition of Internet traffic to an interconnection model as being desirable and that as PT - Comunicações, S.A. did not oppose this possibility, understood that in making the said transition it would be advantageous to adopt a single model because of the complexity involved in the management of more than one model.

Thus a consensus was reached over the ownership of traffic, with the choice of user being considered in this determination. This decision over traffic ownership led to the adoption of the logic of call origination charges as decided.

The next step then was to put together and regulate the model preferred by the majority and which the ICP recognised as being capable of achieving the desired objectives.

But as seen by the regime laid down in nº 3 of article 6 of Decree-Law nº 415/98 such a decision would never be able to avoid future inversions of traffic ownership to be agreed upon by the parties concerned.

This is exactly the situation that was recognised in Deliberation nº 17 of the 31st of July.

2 - TRANSITORY PERIOD AND RESPECTIVE COMPLETION TIME

The setting of a new completion date for the transitory period – now 31/10/2001 – as decided by the Deliberation of July 31st, is based on the fact that the initial period fixed has been seen as being too exiguous, because, contrary to previous ICP forecasts, the majority of ISPs were unable to carry out the necessary alterations to the architecture of their respective networks within that period. PT - Comunicações, S.A. agreed to this alteration when consulted about the matter. Whilst maintaining the possibility of any ISP subscribing to the new model prior to the end of the transitory period, the interests of these bodies must not be affected by the alteration determined here.

3 - COMPENSATORY PAYMENTS

Subjecting Internet traffic to a judicial-economic interconnection model in place of the previous revenue sharing model meant that it would be advisable to establish a transition period, during which the various bodies involved would have to make the alterations necessary for this evolution to take place. The rules to be observed during this transition period will be part of the preparation of the said interconnection model, at the same time being integrated in the powers of intervention of the ICP within the area of interconnection.

Thus, even before the time from which it has to execute the administrative determination which completely fulfils its obligations as the body with significant market power, but after PT - Comunicações, S.A. presented its interconnection reference proposal for Internet traffic on February the 13th of this year, the ICP Board of Directors, exercising its regulatory duties and within the powers conferred by articles 4, nº 2, and 13 of Decree-Law nº 415/98, of December 31st in terms of

interconnection material, decided to make certain changes to "compensatory payments".

The "compensatory payments" constitute prices practised as a result of an agreement made between operators to ensure PT – Comunicações, S.A. remuneration in cases where the ISP bills the end user at a price which is lower than that of the FTS tariff.

It has already been said in the "principle guidelines for a better definition of the provision of Internet access services framework" that: *"The present shared revenue regime within this framework has been questioned many times by those bodies, with all concerned saying that it leads to unprofitable exploration conditions. Furthermore, it has been argued that this regime leads to standards of the use of network resources which are certainly not the most efficient, suggesting that this will be a problem that will become worse with the continuous growth of Internet traffic."*

Confirmation is given in the same document that the second proposal presented by PT - Comunicações, S.A., where the suggested (flat) rates were not related to the fixed telephone service prices, contained the best guidelines to date for the evolution of the Internet access service. Thus, independently from a more in-depth analysis, it was the one that was later used, even though it was known that the compensatory payments made to PT - Comunicações, S.A. by the ISPs would have to be reduced.

As we all know, the "compensatory payments" arose from the difference between the cost of a local call and that of a regional or national call in those cases where, even though the ISPs only bill users for the cost of local calls, they had to pay PT - Comunicações, S.A. the price that corresponded to the other calls. The guiding principle for the costs, to be introduced gradually, implied that, considering the true costs supported by PT - Comunicações, S.A. for regional and national calls, compensatory payments would be reduced during the transitory period.

It was on the basis of these aspects that the so-called “compensatory payments” were reduced by 10% by the Deliberation of the 21st of February 2001.

4 - OFF-PEAK (FLAT RATE) OFFERS

PT - Comunicações, S.A. took the initiative to present off-peak offers for Internet access. They did this on various different occasions, one of which was the public offer made on the 13th of February 2001.

It was the responsibility of the ICP to analyse the prices proposed by the operator to verify their suitability in terms of achieving the desired objectives.

One of the specific obligations of entities with significant market power is that of respecting the principle of cost guidance when fixing prices for interconnection. In order to arrive at the best possible off-peak prices the European Commission recommend that the so-called “best European practices” be taken into account when observing this principle. It is very difficult to find offers with similar characteristics to those of PT - Comunicações, S.A. among the other European Union member States, and Spain was the only country with an offer similar to that which PT - Comunicações, S.A. proposed for Portugal and which could be used as a reference.

Thus:

Interconnection prices paid to FTSO² for Internet access (off-peak offers)

² Fixed Telephone Service Operators

	Unlimited	Off-Peak	Observations
Spain (Telephonic)	–	Int. Local Origination: PTE 2,230	Off-peak hours – Mon. To Fri. from midnight to 8 a.m. and from 6 p.m. to midnight. All day Saturdays, Sundays and Bank Holidays.
	–	Int. Local Termination: PTE 422	
	–	Int. Simple Transfer Origination: PTE 2,270	
	–	Int. Simple Transfer Termination: PTE 542	

At the same time the maximum prices that the ISPs could offer to maintain the minimum level of competitiveness with offers similar to cable network operators were taken into consideration.

These elements were used as a reference when fixing prices for *off-peak* access.

6 PEAK-HOUR OFFERS (SOLD PER MINUTE)

6.1. No 1 of article 4 of Decree-Law nº 415/98 of December 31st prescribes: *the principle interconnection guidelines are aimed at guaranteeing the interests of users efficiently and economically.*

Thus, the principle of economic efficiency (in the sense that goods should be obtained at the lowest costs possible with the technologies available at each moment in time) should be observed for all types of interconnection.

This principle has very real importance and must be rigorously applied within the area of Internet access, *driving force behind the development of all aspects of the information society*, whose accelerated increment was classified as a national priority. This is how we determine the relevance of the public interest to be pursued.

6.2. Those entities with significant market power have, because of that laid down in Decree-Law n° 415/98 dated December 31st, the specific obligation to respect the guiding principle for costs when fixing the prices of interconnection.

In terms of the way in which this rule must be observed, the prevailing doctrine at European Commission level is that the historic costs of these goods and services should not be considered as a reference because the said systems of historic costs tended to include certain inefficiency costs (e.g. costs induced by previous erroneous investment decisions, the implementation of sub-standard network types and technologies, the inefficient contracting of personnel, etc).

The European Commission understands that alternative cost models – namely LRIC (Long Run Incremental Costs) models would be more suitable. In fact, Recommendation n° 8 (published in Official Journal n° L 073, of 12/3/98, pp. 42-50) on Interconnection in a Liberalised Telecommunications Market – Part I – Determination of Interconnection Prices the “opinion of the European Commission that the most suitable approach to take in determining interconnection prices is based on foreseeable average long-term additional costs which in turn would be more in agreement with a competitive market”.

However, there are doubts as to whether the said LRIC models provide suitable answers to the different questions posed in the area of cost optimisation. The EC itself recognises that whilst there are no really credible LRIC models, member States can use the *best European practices* - defined as the interval between the lowest interconnection price in the European Union and the third lowest price in the same zone (see the above quoted Recommendation).

It must be remembered that although those prices considered using the *best European practices* principle were defined using peak-hour termination prices as a

reference and in some countries today there are differences between origination and termination prices, the same situation is not seen in terms of efficiency; in fact, in terms of efficiency and excluding billing and collection costs, origination and termination costs tend to be almost the same.

The difference between origination and termination costs in Portugal comes within a process of liberalisation framework, in relation to which the ICP has followed a plan of progressive readjustment to maintain the global balance of the market.

On the other hand it must be remembered that these prices are defined for a public switch telephone network, which is not an *economically efficient* network for Internet traffic. In terms of economic efficiency – and it is the costs that exist in these conditions that we must look at – it means that this traffic should be routed through a network with a different, more suitable technology (e.g. Internet protocol).

Meanwhile, remembering that it is felt that the guiding principle for costs should be introduced gradually in order to reduce the effects of this imposition on the company concerned, prices were fixed above the best European practices. The average European price for peak-hour offers was taken as a reference.

Again with the intention of reducing the impact of this measure, voice origination prices were taken as a reference for peak-hour Internet traffic, although, due to facts referred to above, it is admitted that they may have been overestimated in the face of existing economically efficient costs. In fact these prices are much higher than *the best European practices* and are very close to average European peak-hour prices (see Table A).

*Table A. Comparisons between European peak-hour prices (November 2000)**

ORIGINATION			TERMINATION		
Local	Single Traffic	Double Traffic	Local	Single Traffic	Double Traffic

INTERNET ACCESS REFERENCE PROPOSAL 2001(IARP 2001)	1\$62	2\$64	4\$63	1\$62 **	2\$64 **	4\$63 **
EU Average (exc. Portugal and Greece)	1\$69	2\$39	3\$31	1\$63	2\$33	3\$23
Best Practice (lower limit)	1\$19	1\$32	1\$66	1\$19	1\$29	1\$46
Best Practice (upper limit)	1\$28	1\$74	2\$18	1\$27	1\$74	2\$47
IARP / EU Average Deviation	-4.1%	10.5%	40.0%	-0.7%	13.3%	43.3%
IARP / B.P. Dev. (lower limit)	35.8%	99.5%	178.8%	35.8%	104.7%	217.1%
IARP / B.P. Dev. (upper limit)	26.8%	51.9%	112.7%	28.0%	51.9%	87.4%

Notes:

* These are prices per minute for calls of 20 minutes average duration. As a precautionary measure prices for November 2000 were taken as a reference for calculation purposes, although it is hoped they will drop in 2001. The following formula was applied to define the base tariff fixed on the 21st of February: *Price, per minute for a call lasting N minutes = (Activation of call + Price per minute * N) / N.*

** For the purposes of comparison and considering that in time origination prices will tend to be the same as termination prices, the figures shown refer to origination prices.

Table B. Comparisons between European off-peak prices (11/00)*

	ORIGINATION			TERMINATION		
	Local	Single Traffic	Double Traffic	Local	Single Traffic	Double Traffic
IARP 2001	1\$00	1\$42	2\$82	1\$00 (*)	1\$42 (*)	2\$82 (*)
EU Average (exc. Portugal and Greece)	1\$02	1\$63	2\$06	0\$98	1\$59	2\$03
Best Practice (lower limit)	0\$64	0\$91	1\$14	0\$64	0\$91	1\$33
Best Practice (upper limit)	0\$70	1\$32	1\$51	0\$70	1\$29	1\$51
Deviation IARP / EU Average	-2.0%	-13.0%	36.8%	1.9%	-10.8%	39.2%
Dev. IARP / B.P. (lower limit)	55.7%	56.7%	146.9%	55.7%	56.7%	112.3%
Dev. IARP / B.P. (upper limit)	42.0%	7.3%	86.2%	43.6%	10.1%	86.2%

Notes:

* These are prices per minute for calls of 20 minutes average duration. Prices for November 2000 were taken as a reference for calculation purposes, although it is hoped they will drop in 2001. The following formula was applied to define the base tariff fixed on the 21st of February: *Price, per minute for a call lasting N minutes = (Activation of call + Price per minute * N) / N.*

** For the purposes of comparison and considering that in time origination prices will tend to be the same as termination prices, the figures shown refer to origination prices.

With a view to promoting access and knowing that the biggest part of Internet traffic occurs during the economic period (also called the off-peak period), it is felt that current prices in the Interconnection Reference Proposal for 2001 (IRP 2001) should not be applied to this period. In fact, the off-peak / peak ratio resulting from IRP 2001 is higher than the equivalent average ratio for the European Union. There is however an ongoing gradual adjustment being made in terms of the voice interconnection reference offer.

It must also be added that the ratio between the average price of calls made in off-peak and those made during peak hours is lower than the same interconnection ratio in relation to fixed telephone service calls in Portugal.

Here we were trying to obtain an approximation of the ratio for existing fixed telephone service prices, aimed at protecting the interests of all users (especially families), which, in the fixed telephone service, now enjoy a significant reduction in off-peak prices.

The prices obtained through the application of this method are still higher than the best European practices and in fact are getting closer to the European averages (see Table B).

Table C. Comparisons between European off-peak prices (11/00)

	ORIGINATION			TERMINATION		
	LOCAL	SINGLE TRAFFIC	DOUBLE TRAFFIC	LOCAL	SINGLE TRAFFIC	DOUBLE TRAFFIC
IARP 2001	0.99	1.41	2.81	0.99	1.41	2.81
EU Average (exc. Portugal and Greece)	1.02	1.63	2.05	0.98	1.58	2.02
Best Practice (lower limit)	0.64	0.90	1.14	0.64	0.90	1.32

Best Practice (upper limit)	0,70	1,28	1,51	0,69	1,25	1,50
Deviation IARP / EU Average	- 2.5 %	- 13.3 %	36.6 %	1.4 %	- 11.1 %	39.0 %
Deviation IARP / B.P. (lower limit)	54.3 %	56.3 %	146.7 %	54.3 %	56.3 %	112.6 %
Deviation IARP / B.P. (upper limit)	40.5 %	9.8 %	85.8 %	43.4 %	12.4 %	87.1 %

7 - ECONOMIC PERIOD

It was decided to extend the *economic period* to cover the time between 6 p.m. and 9 a.m. on weekdays and all day on Saturdays, Sundays and National Holidays, bearing in mind the following:

- The social benefits of enlarging the period – aimed at providing more potential for the benefits of this schedule for a layer of the population for which the hours from 6 p.m. and 9 p.m. are very important, the student population;
- Data collected indicates that various European states have similar offers, e.g. Ireland (6 p.m. – 8 a.m., FS), Sweden (6 p.m. – 8 a.m., FS), the United Kingdom (6 p.m. – 8 a.m., FS) and Italy (6.30 p.m. – 8 a.m., FS);
- PT - Comunicações, S.A. has already recognised the usefulness of this new schedule in generalized offers like *Yesnet*, which in fact uses this schedule.

8 - BILLING

PT - Comunicações, S.A. proposed the provision of a billing and collection service in its public offer of February the 13th 2001.

In the preparatory process of the Deliberation of February the 21st 2001, as referred to in the brief summary of the meeting held on 24.1.201 to discuss matters in this

area, *“various bodies have indicated that the option to solicit this service from the direct access provider, at reasonable prices should be considered, taking current practice into account and the advantages of an integrated invoice for the ISP and the consumer”*.

When exercising the powers conferred by law in terms of interconnection material, it is understood that PT - Comunicações, S.A. must always ensure the billing of traffic destined for the numbering range of the ISPs, at the request of these, and taking the following reasons into consideration:

- The fact that the ISPs are emerging bodies and, as such, intend to create conditions that favour the competition by facilitating the entry of new agents into the market;
- The importance of promoting Internet access;
- The principle of economic efficiency, which leads to the intention of creating a system with the lowest possible total costs;
- The fact that the total cost of the system is lower through avoiding the duplication of services, if the billing and collection service for Internet traffic is the responsibility of PT - Comunicações, S.A. which, as possessor of the fixed telephone service support network, must always bill and collect from its clients;
- User interests, bringing added advantages like a reduction in billing costs (which will be “transferred” from them) and the benefits of receiving a single invoice.

10. BILLING PRICES

PT - Comunicações, S.A. offered to bill at a cost of PTE 7.50 per call.

As there are no European reference figures available nor any European Commission recommendation *direct costs* have been used as the basis for fixing the price of this service.

It should be remembered that billing and collection costs of Internet clients are borne by PTC. The ICP decided that this situation should only continue if PT - Comunicações, S.A. be reimbursed for these costs, with the corresponding increase being made to cover the cost implications involved in this activity.

Such cost increase is actually represented by the increased costs of billing and collection of the Internet access service. In this context, direct costs can be identified as the incremental costs of billing and collection.

The respective calculation was based on direct unit billing costs (per minute), as per the preliminary results of the PT - Comunicações, S.A. Analytic Accounting System for the 1st six months of the year 2000, for an average duration of a call of around 20 minutes.

Common and collective costs were not considered because, as it was not known which should be attributed to billing, the global picture is basically the same as they are already a part of the products and services provided by the company.

11 - PRIMARY ISDN ACCESSES

Although *primary ISDN* access material (digital network with integrated services) is regulated within the bounds of the fixed telephone service, such relative questions as the period of transition and the operational functioning of the new model must be treated globally. The price of *primary ISDN* accesses was an important question in the

global economy of the business under today's conditions, now that most of the ISPs use this service.

Thus article 34, nº 5, of the Regulations for the Exploration of the FTS, approved by Decree-Law nº 474/99, of November the 8th was applied. This establishes that as well as obeying the guiding principle for the costs fixed in nº 4 of the same norm, those entities with significant market power must also practice prices of access and utilisation of fixed telephone networks independent of the type of use they were requested for, except when different services or facilities were requested and without prejudice to that laid down in numbers 3 and 4 of article 10 of Decree-Law nº 415/98, of December 31st.

In fact it was under cover of nº 3, paragraph a), of article 10 of Decree-Law nº 415/98, and taking the respective nº 4 into account, that the ICP ruled that PT - Comunicações, S.A. prepare an Internet Access Proposal (IAPR), fixing different interconnection conditions from those for the voice IAPR.

In the rented circuits market, PT - Comunicações, S.A. practices a set of discounts for operators which on average are over 30%.

In the determination in question, a discount of 20% for all ISPs was established for the use of *primary ISDN accesses* for Internet traffic.

In practice, the reduction of primary ISDN accesses constitutes a discount given to the group of ISPs as a whole and intended to add potential to scale economies due to the foreseeable growth of Internet traffic suggested by greater consumption resulting from even lower prices in peak offers and the existence of off-peak offers, all of which brings positive implications at the level of effective demand, with the above-mentioned effect and consequent reduction in costs.

Special mention must also be made here of the fact that from a static perspective, it can be generally admitted that the supply of primary ISDN accesses to operators implies lower costs than those for supply to the general public.

Thus it is possible to adapt transparent and non-discriminating discount schemes to the legal requirements applicable to these discounts within the bounds of the FTS (art. 36).

This determination benefits the smaller sized operators whose objective is to facilitate the emergence of new agents and thus favouring competition.

On the other hand, and with reference to the readjustment of the prices of primary ISDN accesses, it is perfectly justifiable that priority be given to the variation of the prices for primary ISDN accesses used by ISPs due to the extreme relevance of the social importance of the service they provide.

Finally, reference must be made to the fact that after considering the results of the PT - Comunicações, S.A. Analytic Accounting System for the year 2000 (the confidentiality of which makes it impossible to make a more precise indication), the price reductions made by the ICP are the result of the application of the guiding principle for costs.

12 - RESTRUCTURING OF THE NETWORK

In addition to this point of the Deliberation of the 21st of February this year, in which, accepting the PT - Comunicações, S.A. proposal for restructuring work in the Lisbon and Oporto areas, it was decided that a network restructuring plan for the whole of the country be presented, without setting a fixed date for the same, it was decided on the 31st of July of this year that this plan be submitted to the ICP for approval by the 31st of this coming October. PT - Comunicações, S.A. agreed to this date.

Lisbon, August 22nd 2001.