

BEREC Opinion

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

**Case CZ/2012/1322:
Wholesale broadband access (Market 5) in the Czech Republic**

Date: 23 July 2012

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1. Executive summary

On 11th of May 2012, the European Commission (“the Commission”) registered a notification from the Czech national regulatory authority, Český telekomunikační úřad (hereinafter CTU), concerning the Wholesale Broadband Access (WBA) market in the Czech Republic. CTU proposes to include in the WBA market access through xDSL and FTTx platforms, as well as through cable and Wi-Fi. CTU does not find that cable and Wi-Fi exercise a direct constraint, but CTU includes them in the product market on the basis of the indirect constraints they exercise. CTU proposes the division of the national territory into two relevant geographic sub-markets:

- Segment A, where at least 3 competing infrastructures are present (cable, xDSL and Wi-Fi or FTTx, xDSL and Wi-Fi) and where the market share of Telefónica does not exceed 40%; and
- Segment B, covering all other locations.

In segment A, CTU finds that no company has SMP and proposes the imposition of no remedies. In segment B, CTU finds that Telefónica has SMP and proposes the imposition of the following obligation on the xDSL network of the SMP operator:

- Transparency;
- Non-discrimination;
- Accounting separation; and
- Access.

The Commission has expressed serious doubts in relation to the non-imposition of effective remedies in an NGA context and the non-imposition of a cost orientation obligation.

Based on the Framework Directive, BEREC is issuing the current opinion on the serious doubts expressed by the Commission in accordance to Article 7(a). BEREC has already issued separately another opinion on the serious doubts expressed by the Commission in accordance to Article 7.

Concerning the exclusion of FTTx, BEREC does share the Commission’s serious doubts that the access obligation does not clearly include all of Telefónica fibre network. BEREC stresses the need to provide legal certainty and clarity on the obligations imposed which is crucial to promoting effective competition and efficient investment. Therefore BEREC encourages CTU to explicitly specify which access technologies fall under the access obligation provided for in the proposed remedy; and explicitly states if FTTx is included to avoid any confusion that may arise.

Concerning the serious doubts expressed by the Commission regarding the non-imposition of cost orientation obligation, BEREC shares the serious doubts of the Commission. Indeed, considering the proposed geographical market segmentation, BEREC considers that CTU did not produce enough evidence on a forward-looking basis and thus, that CTU did not prove that the risk of applying excessive prices in the future does not exist. . In order to avoid the risk of imposing wholesale price in a level that would prevent alternative operators to

effectively seek for access in segment B, BEREC considers that a price control remedy is deemed necessary in the present case.

2. Introduction

On 11th of May 2012, the European Commission (“the Commission”) registered a notification from the Czech national regulatory authority, Český telekomunikační úřad (hereinafter CTU), concerning the Wholesale Broadband Access (WBA) market in the Czech Republic.

On May 16th 2012, the Commission sent a request for information (RFI) to CTU and a response was received on 21 May 2012. A supplementary RFI was sent on 25 May 2012 and a response was received on 31 May 2012.

The Commission initiated a phase II investigation, pursuant to Article 7 and pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC (Framework Directive), with a so called serious doubts letter on June 11th 2012. In accordance with the BEREC rules of procedure the Expert Working Group (EWG) was established on June 14th 2012 with the mandate to prepare an independent BEREC opinion on the justification of the Commission’s serious doubts on the case.

On 19th of June 2012 the initial meeting of the EWG took place in Paris. During this meeting, the EWG invited CTU to gather further information and clarification on the notification.

A draft opinion was finalized on the 17th of July 2012 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 23rd of July 2012. This opinion is now issued by BEREC in accordance with Article 7(a) of the Framework Directive.

3. Background

The first review of the wholesale broadband access market was conducted in 2006 under case CZ/2006/0449. CTU defined a single national market for wholesale broadband access comprising access provided over xDSL and FTTx technologies. However, CTU excluded Wi-Fi, cable and CDMA platforms from the WBA market since these infrastructures did not offer access equivalent to bitstream access. CTU designated Telefónica as having significant market power and imposed on it obligations of access, transparency, non-discrimination and accounting separation. The Commission invited CTU to impose a price control mechanism to avoid a margin squeeze risk, as well as the obligation to provide access at connections at ATM level and/or DSLAM level.

The second review of the wholesale broadband access market was conducted in 2008 under case CZ/2008/0797. CTU defined a single national market for wholesale broadband access comprising access provided over xDSL technologies. CTU excluded FTTx, cable, Wi-Fi,

FWA, CDMA and UMTS platforms from the WBA market. CTU designated Telefónica as having significant market power and maintained the same obligations as in the first review. The Commission questioned the exclusion of FTTx from the market. It also questioned CTU's broad definition of the retail market including mobile and wireless products and invited CTU to follow-up closely the impact of retail competition on the relevant wholesale market and to check the SMP finding accordingly.

4. Assessment of the serious doubt: non-imposition of effective remedies in an NGA context

a. Exclusion of FTTx

Concerns of the Commission

The Commission expressed serious doubts *“that the Access obligation proposed by CTU for the SMP operator is compliant with EU law and in particular with Article 8(4) and 12 of the Access Directive in conjunction with Article 8 and Article 16(4) of the Framework Directive, in so far as it does not clearly include all of the SMP operator’s fibre deployment on a forward-looking basis”*. The Commission has serious doubts that *“an access obligation that does not clearly include all of Telefónica fibre network, including FTTH, would be in the end-user’s interest and would not hinder the emergence of sustainable competitive market”*. The Commission also invokes its NGA Recommendation in support of its doubts.

CTU opinion

CTU is of the view that the NGA Recommendation is not applicable to the present case, as Telefónica does not have wholesale offer on FTTx and its VDSL wholesale offer is based on copper infrastructure. Irrespective of the above the CTU states that the access obligation stipulated in the proposed remedy is of general nature and does not only include Telefónica's xDSL network but also Telefónica's FTTx network.

BEREC's view

The question in this regard is whether CTU has to include all of Telefónica fibre network in the access obligation.

With regard to the Commission's serious doubts concerning non-imposition of effective remedies in an NGA context, BEREC first reminds that, as provided in article 8.4 of directive 2002/19/EC (“access directive”), NRAs should, after finding SMP in accordance with the market analysis and based on objective market factors, impose the appropriate regulatory obligations, which have to be *“based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of Directive 2002/21/EC”*.

Paragraph 31 of the NGA Recommendation stipulates that where SMP is found on Market 5, wholesale broadband access remedies should be maintained or amended for existing services and their chain substitutes. Furthermore paragraph 33 states that NRAs should mandate the provision of different wholesale products that best reflect the technological capabilities inherent in the NGA infrastructure in terms of bandwidth and quality so as to enable alternative operators to compete effectively, including for business grade services.

BEREC shares the Commission's view as to the applicability of the NGA Recommendation to the present case. The draft remedy unambiguously indicates that Telefónica's network operates increasingly in an NGA environment: "the share of solutions based on FTTx is continuously increasing and in some regions these solutions gain an important position in the offer of broadband services"¹.

In consequence BEREC points out that the remedies proposed by CTU should take the utmost account of the NGA Recommendation. In the present case, it seems reasonable and relevant to include fibre networks in the access obligation on Market 5.

Firstly, as regards the Commission's serious doubts that the non-imposition of access obligation on Telefónica's FTTH network constitutes a breach of the EU law, as pointed out by BEREC in the Opinion on Case NL/2012/1299, pursuant to Article 19 (2) of the Framework Directive NRAs can choose not to follow a recommendation. Thus the assessment of the compatibility with EU law cannot be based only on non-compliance with the NGA Recommendation. However, according to Article 19 of the Framework Directive, NRAs should take the utmost account of the Commission's recommendations. When a NRA does not follow a recommendation, it has to inform the Commission and give the reasons for its position.

Secondly, BEREC points out that according to CTU the access obligation provided for in the proposed remedy is of general nature and will apply also to FTTH services once they are provided by Telefónica on the market.

Similarly the analysis of the proposed access obligation in part 4.3 "Draft remedies" of the draft decision indicates that Telefónica's fibre networks are neither explicitly stated as falling under the access obligation, nor are they excluded from it. Since Telefónica's FTTx networks have been included in the relevant market definition it can be concluded that a general obligation to provide access envisaged in the draft decision is also applicable to these networks.

In light of the above BEREC does share the Commission's serious doubts that the access obligation does not clearly include all of Telefónica fibre network. BEREC stresses the need to provide legal certainty and clarity on the obligations imposed which is crucial to promoting effective competition and efficient investment. Therefore BEREC encourages CTU to explicitly specify which access technologies fall under the access obligation provided for in the proposed remedy; and explicitly states if FTTx is included to avoid any confusion that may arise.

¹ Section 2.1.3.8 "The conclusion to assessment of substitutability with respect to possible substitutes in the wholesale market of broadband access" of the draft remedy, p.79.

b. Non-imposition of a price control remedy

Concerns of the Commission

The Commission expressed serious doubts “*that the lack of cost orientation or price control remedy on the xDSL and FTTx networks of Telefónica is compliant with EU law*”. The Commission considers that “*the evidence adduced by CTU was not sufficient to demonstrate that wholesale prices charged by Telefónica are not excessive*”. Further, the Commission is concerned that “*in absence of a price control remedy the proposed measure will not promote efficiency and sustainable competition*”.

CTU opinion

According to CTU the cost orientation obligation has not been proposed as CTU evaluated trends regarding prices and profitability and considered whether the current absence of price control causes competitive problem in form of unreasonably high prices to the detriment of final consumers. Furthermore CTU has conducted a price and profitability analysis according to which it considers that there is no problem of excessive pricing on Market 5 as wholesale prices are decreasing in absolute terms, whilst the speed of services provided is increasing. CTU stated that its analysis of profitability of services over the past three years shows profits slightly but consistently exceeding the percentage of return on invested capital, and that an international comparison of wholesale prices shows that the prices are in line with international averages. Based on this evaluation, CTU did not find that excessive prices have been applied on the relevant market, and concluded that a cost orientation obligation would be disproportionate and inappropriate.

BEREC's view

Concerning the compliance with EU law, as pointed out by BEREC in the Opinion on Case NL/2012/1299, pursuant to Article 19 (2) of the Framework Directive NRAs can choose not to follow a recommendation. Thus the assessment of the compatibility with EU law cannot be based only on non-compliance with the NGA Recommendation. However, according to Article 19 of the Framework Directive, NRAs should take the utmost account of the Commission's recommendations. When a NRA does not follow a recommendation, it has to inform the Commission and give the reasons for its position.

BEREC first reminds that, as provided in article 8.4 of directive 2002/19/EC (“access directive”), NRAs should, after finding SMP in accordance with the market analysis and based on objective market factors, impose the appropriate regulatory obligations, which have to be “*based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of Directive 2002/21/EC*”.

In its common position on remedies², ERG established a link between competition problems and appropriate remedies according to the electronic communication framework. In this document, ERG suggested that NRAs should use cost orientation in order to establish the appropriate wholesale price. ERG also considered that *“the imposition of cost-orientation should follow the market analysis and be based on the specific competitive conditions. Therefore, it is not appropriate to presume general obligation of cost-orientation nor to make mechanistic exemptions”*.

According to CTUs reasoning, imposing cost orientation obligation in the present case would be disproportionate as prices are not excessive or unreasonably high to the detriment of final consumers. While BEREC acknowledges the right of particular NRAs to choose the appropriate remedies in regard to identified market failures and does not consider that cost orientation obligation as a principle is appropriate in every case, BEREC shares Commissions Serious Doubts basing strictly on evidence deficiencies described below.

In principle, BEREC agrees with the Commission that in certain circumstances excessive prices can be charged even in the absence of a risk of margin squeeze. A margin squeeze test is appropriate to prove that wholesale prices are not excessive relative to retail prices. BEREC notes however that a margin squeeze test in itself does not necessarily prevent wholesale prices being excessive in absolute terms, even if they are not excessive in relation to retail prices. In other words, high wholesale prices, even if enabling an alternative operator to compose a retail offer that is competitive to the vertically integrated incumbent operator’s retail offer, may result in setting overly-high retail prices to the detriment of final customers.

CTU, in order to prove that prices are not excessive in absolute terms applies a benchmark based comparison with prices observed in other European countries which have imposed a cost orientation obligation and states that a trend of diminishing prices in absolute terms on the Czech broadband access market is visible.

In its common position on remedies, ERG indicates that *“to the extent that it would be considered disproportionate to impose cost-orientation and cost-accounting obligations (e.g. on small operators) or where appropriate cost models do not yet exist, other forms of price-control could be considered for such operators, such as benchmarking against the larger operators who are under a cost-orientation obligation”*.³

In consequence, it has to be underlined that according to BEREC, a benchmark may be appropriate only when it has been previously established that imposition of cost-orientation and cost-accounting obligations would prove to be disproportionate. However a benchmark should not be used to reach that conclusion, as it in fact does not take into account different cost structures in the Member States and its results do not guarantee proper assessment of meeting the prerequisites for non-imposition of cost orientation obligation. BEREC therefore reiterates that the decision on the imposition of relevant remedies should follow the market analysis and should be based on the specific competitive conditions.

² (ERG(06)33) Revised ERG Common Position on the approach to appropriate remedies in the ECNS regulatory framework.

³ (ERG(06)33) Revised ERG Common Position on the approach to appropriate remedies in the ECNS regulatory framework, p. 79.

Furthermore, in regard to the Commission's doubts concerning the arguments that there is a trend of diminishing prices on Czech Market 5 justifying the nonexistence of excessive prices, BEREC agrees with the Commission that this trend may be caused by the diminishing cost base, what was raised by CTU in its notified draft decision.

Apart from that question, BEREC considers that in segment B, where competition of alternative infrastructures is weaker, the SMP operator could have the incentives to impose prices that are *de facto* preventing an efficient entry in the market, emptying out the access obligation imposed. In addition, absent any obligations on economic conditions there is the risk of appearance of disputes that CTU should solve in a case by case basis, potentially delaying access of alternative operators.

Moreover, BEREC stresses that any market analysis should be conducted at a forward looking basis and measures adopted on the basis of the findings thereof should prevent possible constraints and market failures in the future.⁴ CTU on the other hand did not provide any evidence that the trend of diminishing prices on the relevant market in question would be sustained in the future, in particular in the light of the proposed geographic market segmentation. CTU did not put forward any evidence that effective competition found on Segment A would exert competitive pressure on Telefónica in Segment B, thus contributing to the continuation of price decreases.

Since a segmented wholesale broadband access is envisaged by CTU, the situation on the retail market would have to be analysed for segment B to assess whether the imposition of the cost-orientation obligation is justified or whether the margin squeeze test is sufficient.

In the light of the above BEREC is of the view that CTU has not proven sufficiently that there are no excessive prices in absolute terms on Czech Market 5, and in particular that CTU has not proven that those prices would not become excessive in the future on a forward looking basis.

With regard to the margin squeeze test and CTU's arguments, provided in the response to Request for Further Information (hereinafter RFI), that CTU assessed whether there was a margin squeeze repeatedly in years 2008 - 2010 due to complaints of alternative operators referring to the low margin between Telefónica's specific (temporary) acquisition offers on the retail market and their upstream offers on relevant Market 5, BEREC notes that according to information presented by Telefónica in response to question 8 of the RFI, Telefónica begun deployment of its fibre networks only in the fourth quarter of 2010, which means that the margin squeeze tests executed by CTU did not include data for Telefónica's fibre network. Moreover, the margin squeeze test conducted by CTU cannot prove in itself that prices will not be excessive in the future, in particular in the light of the proposed Market 5 segmentation. In other words CTU did not take into consideration market changes that may occur subsequently, and its approach to the excessive pricing issue cannot be regarded

⁴ (Bor(12)26) BEREC Opinion on Phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC: Case NL/2012/1299 Wholesale broadband access (Market 5) and wholesale terminating segments of leased lines (Market 6) in the Netherlands

forward looking. BEREC thus notes the same deficiencies with regard to this question as to the question of excessive prices in absolute terms.

Summarizing, BEREC shares the Commission's opinion that in certain market circumstances excessive prices can be charged even in the presence of a margin squeeze test which prevents the occurrence of margin squeeze. In BEREC's opinion the evidence produced by CTU has not been analyzed on a forward looking basis, and does not prove with a sufficient level of certainty that there is no risk of applying excessive prices in the future in Segment B, in particular in the light of the proposed geographical market segmentation and deregulation in Segment A. In order to avoid the risk of imposing wholesale price in a level that would prevent alternative operators to effectively seek for access in segment B, BEREC considers that a price control remedy is deemed necessary in the present case.

5. Conclusion

On the basis of the review of the available documents and other information supplied by CTU, BEREC draws the following conclusions on the justification of the serious doubts.

Concerning the exclusion of FTTx, BEREC does share the Commission's serious doubts that the access obligation does not clearly include all of Telefónica fibre network. BEREC stresses the need to provide legal certainty and clarity on the obligations imposed which is crucial to promoting effective competition and efficient investment. Therefore BEREC encourages CTU to explicitly specify which access technologies fall under the access obligation provided for in the proposed remedy; and explicitly states if FTTx is included to avoid any confusion that may arise.

Concerning the serious doubts expressed by the Commission regarding the non-imposition of a cost orientation obligation, BEREC shares the serious doubts of the Commission. Indeed, considering the proposed geographical market segmentation, BEREC considers that CTU did not produce enough evidence on a forward-looking basis and thus, that CTU did not prove with a sufficient level of certainty that there is no risk of applying excessive prices in the future in Segment B. In order to avoid the risk of imposing wholesale price in a level that would prevent alternative operators to effectively seek for access in segment B, BEREC considers that a price control remedy is deemed necessary in the present case.