

**ECTA Response to BoR (14) 123****Public consultation on draft****BEREC Guidance on the regulatory accounting approach to the economic replicability test (i.e. ex-ante/sector specific margin squeeze tests)<sup>1</sup>****24 October 2014**

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**A. Introduction**

ECTA, the European Competitive Telecommunications Association, welcomes the opportunity to comment on BEREC's draft Guidance on the regulatory accounting approach to the economic replicability test (i.e. ex-ante/sector specific margin squeeze tests).

ECTA very much appreciates the thorough and comprehensive analysis carried out by BEREC in its draft Guidance and the useful summary presentation of its findings at the 2<sup>nd</sup> BEREC Stakeholder Forum meeting. ECTA would also like to thank BEREC for organising a stakeholder discussion on its draft Guidance in the context of the Stakeholder Forum meeting and the opportunity to share ECTA's preliminary remarks. Our comments below are aimed at constructively further improving and fine tuning the text of the draft Guidance.

ECTA wishes to emphasise from the outset that:

- 1. Rigorous ex-ante margin-squeeze testing goes well beyond the 'Economic Replicability Test' (hereafter ERT) contained in the 2013 EC Recommendation on Non-Discrimination and Costing Methodologies (hereafter 'the 2013 EC Recommendation'). ECTA requests BEREC to: (i) make this an explicit unequivocal statement in the final text of its Guidance document, and (ii) change the title of the final document in order to avoid undue amalgamation of concepts.**
- 2. Rigorous ex-ante margin-squeeze testing can be appropriate to address Significant Market Power on all markets, not only Market 3 (a) and (b) of the 2014 edition of the EC Recommendation on Relevant Markets Susceptible to Ex-Ante Regulation (hereafter 'the 2014 EC Recommendation'). Indeed, NRAs have in the past, for example, applied ex-ante margin-squeeze tests to wholesale terminating segments of leased lines (now part of Market 4 of the 2014 EC Recommendation) and to voice markets as well. ECTA requests BEREC to emphasise in the final text of its Guidance document that rigorous ex-ante margin-squeeze testing can be equally appropriate for Market 3 (a) and (b) of the 2014 EC Recommendation as for other markets. ECTA also supports BEREC's statement (last sentence of Section 2.1.1) that a wider list than the 5 parameters listed in the 2013 EC Recommendation needs to be considered. ECTA asks BEREC to include this also in the concluding section of its final Guidance document.**

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<sup>1</sup> The views expressed in this submission represent those of alternative telecoms operators and cannot be held to reflect the views of those members with incumbent interests

3. Ex-ante margin-squeeze testing is an important instrument in the toolbox of NRAs, primarily supporting the non-discrimination obligation provided for under Art. 10 of the Access and Interconnection Directive 2002/19/EC (as amended by 2009/140/EC), and is **not a substitute for price control and cost accounting obligations** (Art. 13 of the same directive). Indeed, non-discrimination remedies (incl. ex-ante margin-squeeze testing) and price control **remedies serve different purposes, and it has proven necessary to apply both remedies (alongside other remedies) simultaneously** in numerous cases, as NRAs' track record shows (see also Section 3.1 of the consultation document). **ECTA requests BEREC to emphasise the non-substitutability of the non-discrimination (incl. ex-ante margin-squeeze testing) and price control remedies in the introductory section and in the conclusions of its final Guidance document.**
  
4. ECTA is a long-standing advocate of rigorous ex-ante margin-squeeze tests having to be applied on a wholesale-downstream relationship, addressing not only the specific case of a wholesale-retail squeeze, but also wholesale-wholesale squeeze between access charges. Wholesale-wholesale squeezes have proven to occur, and such a squeeze was sanctioned ex-post<sup>2</sup>. **ECTA requests BEREC to systematically use wholesale-downstream as its reference point, rather than wholesale-retail, and to reflect this throughout its final Guidance document, in order to ensure that NRAs are fully confident to address wholesale-wholesale squeeze.**
  
5. ECTA is on record in advocating that NRAs' **ex-ante margin-squeeze tests should be complemented by ex-post checks by the NRAs**, in order to verify that the assumptions the NRA made at the time of the ex-ante test were effectively correct. This is important, because judgment calls usually have to be made by the NRA about expected take-up, traffic volumes, effects of promotions (and prolongations and roll-overs of promotions), customer lifecycles, etc. **ECTA requests BEREC to ensure that NRAs are fully confident to conduct ex-post checks. For this to be the case, the Guidance document needs to address ex-post checks.** This is without prejudice to the application of competition law.
  
6. We agree with BEREC's statement in the introduction that **copper-based products cannot be excluded**, neither from an assessment conducted with reference to the 2013 EC Recommendation, nor from an assessment in any other context. **The application (or not) of ex-ante margin-squeeze testing does not depend on technology or the absence of ex-ante price control, it is a matter of ensuring non-discrimination.**
  
7. Margin-squeeze has proven to be **prevalent problem** in EU telecommunications markets. This was powerfully exemplified on 15 October 2014, when the European Commission imposed a fine on a **margin-squeeze recidivist**<sup>3</sup> in an ex-post proceeding.

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<sup>2</sup> Final judgment on appeal in Telefonica case:

<http://curia.europa.eu/juris/liste.jsf?language=en&jur=C,T,F&num=t-336/07&td=ALL>

<sup>3</sup> Commission fines Slovak Telekom and its parent, Deutsche Telekom, for abusive conduct in Slovak broadband market - [http://europa.eu/rapid/press-release\\_IP-14-1140\\_en.htm](http://europa.eu/rapid/press-release_IP-14-1140_en.htm)

If ex-ante margin-squeeze had been conducted adequately in due time (back to 2005 at least), alternative operators would have been able to viably enter the Slovak market without delay, for the benefit of the Slovak Republic's consumers, businesses and public administrations, thereby enhancing domestic, European and global competitiveness of European firms.

On the basis of the above, and also given statements made by dominant operators, including at BEREC's Stakeholder Event on 16 October 2014, **ECTA urges BEREC to stand firm on the necessity for NRAs to be empowered to conduct rigorous ex-ante margin-squeeze testing (including relating to Markets 3 (a) and (b) of the 2014 EC Recommendation), on its detailed implementation, and not to yield to suggestions for modified tests which amount to permitting margin-squeeze. Similarly, we urge BEREC not to acquiesce declarations to the effect that some forms of margin-squeeze would 'not be bad' and should be permissible.** This is without prejudice to permitting retail market penetration pricing strategies under specific ex-ante conditions and with ex-post supervision, insofar as the penetration pricing strategies concerned do not cause a margin-squeeze. This can be achieved, for example, by involving access takers in the penetration pricing strategy (which should objectively be in the interest of all operators, unless a dominant operator pursues market foreclosure), by adjusting wholesale charges for the relevant period.

**Overall, ECTA considers that BEREC Guidance should contain an explicit list of best practice for rigorous ex-ante margin-squeeze testing, and we urge BEREC and all NRAs to stand firm on ensuring absence of any margin-squeeze.**

**Our comments hereafter focus on the specific points in the draft on which we request improvement, in order to maintain, promote, and enhance competition going forward.**

## **B. Comments on Section 2: Parameters of the ex-ante economic replicability test as applied by the 2013 EC Recommendation**

Section 2 of BEREC's draft Guidance document consists essentially of a description of Annex II of the 2013 EC Recommendation on Non-Discrimination and Costing Methodologies. This therefore requires no comments from ECTA. In a few instances, BEREC's makes interpretative points. We briefly address some these interpretative points below.

**2.1.1 para 3:** We welcome and support BEREC's reference to: "*(or between two wholesale prices at different stages of the value chain respectively)*". As indicated in the introduction above, wholesale-wholesale squeeze has been proven to occur in EU telecoms markets, and ECTA believes that it needs to be addressed by NRAs. We ask BEREC to re-state this point in the concluding section of the final Guidance document.

**2.1.1 last para and footnote 10:** We agree with BEREC that a wider list of points than the 5 parameters listed in the 2013 EC Recommendation needs to be considered when developing best practice for the application of rigorous ex-ante margin-squeeze testing. We ask BEREC to re-state this point in the concluding section of the final Guidance document.

**2.2.2 para 1:** We have difficulties understanding this paragraph. We urge BEREC to ensure that it cannot be interpreted as BEREC endorsing a situation in which alternative operators are deprived from achieving a rate of return, which is needed for them to remain a going concern, and is necessary for them to have prospects of climbing the ladder of investment. In ECTA's view, BEREC should recommend an approach which enables a reasonably efficient downstream competitor to earn a normal profit.

**2.2.5.2 last para:** We agree entirely with BEREC that given the importance of bundles, non-regulated wholesale costs represent a material proportion of downstream costs and therefore should be considered a relevant parameter in the margin squeeze test. We ask BEREC to include a statement to the effect that best practice dictates the inclusion of this parameter.

**2.4.3 last para:** We agree entirely with BEREC. Best practice dictates that bundles and cross-subsidies between elements of the bundles are comprehensively addressed. We ask BEREC to include a more explicit statement to this effect.

**2.4.5 last para:** We agree that temporary discounts must be addressed, since they are widely practiced. We urge BEREC to add other points and examples, e.g. many SMP operators prolong the reduced price component of their promotions, some even have rolling-over promotions (so the customer is basically always on the prolonged or on the next promotion without defaulting back to standard pricing) and we are also aware of an SMP operator which offered the takers of a promotion a €100 cashback after 6 months.

### **C. Section 3: Basic methodological choices of the ex-ante margin squeeze mechanics currently applied by NRAs (current practice)**

Section 3 of BEREC's draft Guidance document consists of a description of NRA practices. This requires no comments from ECTA.

### **D. Comments on Section 4: Economic rationale and implementation of the ex-ante economic replicability test of the Recommendation in practice**

ECTA considers that there is **clear merit in pursuing alignment of NRAs' ex-ante margin-squeeze testing methodologies and practices**, including the extension of best practices to those Member States where ex-ante margin-squeeze testing has not yet been introduced, and those Member States where it could usefully be further developed based on best practice.

However, this **should not result in a 'lowest common denominator'** approach, and, **specifically, it should not result in reducing well-established practice in the majority of Member States to a more limited, less ambitious standard which might be drawn from the 2013 EC Recommendation** which addresses a subset of the markets that NRAs must consider for ex-ante regulation. We reiterate in this context (see the introduction above) that ex-ante margin-squeeze testing must be rigorous, must be pro-competitive, and is appropriate for markets other than Market 3 (a) and (b) of the 2014 EC Recommendation.

**4.1: ECTA cautions BEREC on the tentative conclusion put forward in Section 4.1** of the consultation document, where BEREC suggests that: *“The primary objective of the ex-ante economic replicability test is to safeguard competition in cases where no other cost-oriented price regulation pursuant to Art. 13 Directive 2002/19/EC is imposed. Moreover, the ERT is used to ensure non-discrimination and transparency, preventing exclusion from the market”*. **Whilst this may be an accurate description of the 2013 EC Recommendation, ECTA considers that this tentative conclusion is not the appropriate one for BEREC to reach. ECTA considers that ex-ante margin-squeeze testing and (cost-oriented) wholesale price control remedies serve different purposes. NRAs’ track record shows that it has proven necessary to apply both remedies (alongside other remedies) simultaneously in numerous cases. ECTA requests BEREC to amend this tentative conclusion, to read: “The primary objective of the ex-ante economic replicability test must be to safeguard and enable competition. Where NRAs consider it necessary to apply this test measure, they shall set out their reasoning for the measure being imposed, either on a stand-alone basis or on complementary basis, in conjunction with other remedies for Significant Market Power.” ECTA also requests BEREC in this context to: (i) emphasise the non-substitutability of the non-discrimination (incl. ex-ante margin-squeeze testing) and price control remedies in the final text of its Guidance document, and (ii) remove the suggestion (last para of Section 4.1) that the ERT would be an indirect (“lighter”) form of price control replacing a direct (“strict”) form of price regulation.**

**4.1.1: ECTA also cautions BEREC on the tentative conclusion put forward in this section** of the consultation document, where BEREC suggests that: *“The ex-ante economic replicability assesses whether the SMP operator’s retail price of the ‘flagship product(s)’ or the products considered relevant by the NRA covers the regulated wholesale costs, non-regulated input costs (incl. own network costs) and retail costs (LRIC+).” Whilst this may be an accurate description of the 2013 EC Recommendation, ECTA considers that this tentative conclusion is not the appropriate one for BEREC to reach. ECTA considers that ex-ante margin-squeeze testing should ensure that a reasonably efficient downstream competitor relying on access to the dominant operators’ non-replicable bottleneck facilities can earn a normal profit, enabling re-investment in climbing the ladder of investment. **ECTA requests BEREC to amend this tentative conclusion, to read: “The ex-ante economic replicability must assess whether the SMP operator’s wholesale charges (including assessment of any wholesale short or long-term or volume discounts) cover the regulated wholesale costs, non-regulated input costs (incl. own network costs) and any commercialisation costs (LRIC+), in order to enable a reasonably efficient competitor to compete on all downstream (wholesale and retail) markets.”** The proposed formula for the calculation of the ex-ante economic replicability contained in Section 4.1.1 should be adjusted accordingly, notably to enable not only downstream retail markets, but also downstream wholesale markets.*

**4.1.2:** We fully endorse BEREC’s conclusion on this point, i.e. that the REO/adjusted EEO test is preferable, for the markets covered by the 2013 EC Recommendation, as well as for other markets. ECTA is on record as opposing the EEO test and preferring the REO test, and we hereby explicitly confirm this preference. Where a REO test or a scale-adjusted EEO test is used, it should objectively examine the scale of operators within the relevant market, and carefully examine technical, legal, regulatory barriers to further scale acquisition by operators. Such barriers may include operators’ stronger positions on other markets such as

wireless/mobile communications, state ownership/funding of some wireline operators (incl. cable networks), and potential regulatory gaming.

**4.2.2:** We find this section of the consultation document difficult to understand. We agree that a margin-squeeze test should support efficient build-or-buy signals, and we therefore agree with BEREC's statement to the effect that investments from alternative operators should be stimulated when efficient. Indeed, ECTA has repeatedly argued that policy and regulation should not only address incumbent investment incentives (which have been shown to be subject to limited effects from wholesale access regulation)<sup>4</sup>, but should focus on enabling alternative operators' investment (which is in many cases conditioned on wholesale access regulation), to facilitate climbing up the ladder of investment. However, we find BEREC's proposed text in Section 4.2.2 (just two paragraphs) ambivalent. Is it implicitly suggested (para 1 and 2 read in conjunction) that alternative operators would only receive a reasonable return *on their own investments* and not when they take up access to objective economic bottleneck resources? We emphasise in this regard that alternative operators must be able to achieve a rate of return, and must have prospects of climbing the ladder of investment, through re-investment. We fail to see how prospects for *large-scale* genuine new infrastructure competition (stand-alone or through co-investment) can be realised, without ensuring that a reasonably efficient downstream competitor can earn a profit from using wholesale access to objective economic bottlenecks (duct/pole access, physical access to copper and fibre subloops/terminating segments, MDF/ODF access, backhaul where needed, etc.). This statement is made without prejudice to the fact that, well over a decade after the first FttB/H deployments, alternative operators remain in a leadership position on genuine fibre access, in the *small-scale* areas where this has proven to be possible. **We urge BEREC to re-examine this section.**

**4.2.4:** We caution against the NRA unilaterally determining an 'average user'. Alternative operators tend to attract, and want to attract, the more dynamic users in the market, and should not be prevented from meeting those users' demands on account of conservative averages. Full public consultations (including users) on determining the relevant user profiles will be essential to ensure that the determination is not held back by reference to the more inert mass of users who will catch-up with the leading edge in due course.

**4.2.5:** We caution against the NRA unilaterally determining a 'most relevant regulated input' or a 'mix of wholesale access products', and 'flagship retail products'. Alternative operators' business logic should not be 'second guessed' by NRAs. Full public consultations, involving all operators, are necessary to establish, including on a regional basis, and market segment basis, the approaches pursued by operators, large and small, to satisfy the needs of their customers. This includes the types of customers served (consumer, SME, larger business; local, regional, national, cross-border), the role that operators play in the relevant value chains, e.g. some operators focused on raw transmission, others focused on a broader ICT ecosystem, and yet others focused on various (downstream) markets/market niches. Attention is needed in particular to ensuring that the very varying needs of SME end-users are not left aside. A European SME's telecommunications needs, irrespective of whether

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<sup>4</sup> Page 214-215 of European Parliament ITRE Committee Study: Entertainment x.0 to Boost Broadband Deployment. October 2013.  
<http://www.europarl.europa.eu/document/activities/cont/201310/20131017ATT72946/20131017ATT72946E N.pdf>

they have 5-10 (not to mention 50-250) employees, can range from quasi-consumer grade to the most demanding standard for resilience and bandwidth, depending on the business they are in. We should all hope that there will be more and more European SMEs requiring more than consumer-grade broadband, as this will help to rejuvenate Europe's economy, and BEREC should ensure that none of these new businesses is impeded by lack of competitive supply of telecommunications services.

**4.2.5.1: Irrespective of the extent of regulatory obligations, i.e. not only in the absence of wholesale price regulation, NRAs should fully take into account the access price that the SMP operator effectively charges itself and third-party access seekers for the relevant regulated wholesale input.** In any event, **wholesale access charges should be equivalent to the price charged to the SMP operator's own downstream arms (wholesale and retail), i.e. non-discriminatory (including any discounts, be they short-term or long-term or otherwise construed).** Charges listed in the reference offer need to be tested objectively against the reality of what the SMP operator charges all of its own downstream channels.

**4.2.5.2:** We are **surprised by the brevity of this section on non-regulated (wholesale) inputs** (incl. own network costs) in the BEREC consultation document. **We strongly request that this section, which is where BEREC is expected to express its Guidance, is substantially boosted to address the recommended treatment of non-regulated input costs by NRAs.** Indeed, Section 2.2.5.2 of the consultation document (which we endorsed above) is far clearer than this section 4.2.5.2. More generally, this triggers an ECTA comment to the effect that BEREC's guidance should be clearly and unambiguously be brought together, and not be scattered throughout various sections (including the more descriptive sections) of the document.

**4.3:** We agree that average customer lifetime is a relevant parameter, but we emphasise that this should only refer to, or at least give prevalence to, the customer lifetime of the customers displaying switching behaviour, i.e. exclude the important proportion of customers who do not take up new offers/bundles, and who do not switch or intend to switch, for the reasons they express<sup>5</sup>. Clearly, there is a substantial proportion of 'non-switchers' in the market (likely concentrated among customers of incumbent telecom operators and cable network operators).

**4.4.1:** We consider that in many cases it is, and will be, necessary and appropriate to submit all relevant products (not only "flagship products" as expressed by the EC, and not just "a wider range set of retail products" as expressed by BEREC), but ALL (not only retail) products, to ex-ante margin-squeeze testing. We welcome BEREC's recognition of part of this in this paragraph 4.4.1. **However, we emphasise that this paragraph should be amended to address ALL downstream products (be they retail or wholesale).** We also welcome that BEREC states that ex-ante margin-squeeze testing is **mainly used by NRAs as a complementary tool and not as a substitute** to wholesale price control. **ECTA requests BEREC to amend this paragraph, and to put more emphasis on it. It is a key paragraph, which, in the draft, is not given the prominence it deserves.**

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<sup>5</sup> Page 87-91 of Special EuroBarometer 414 E-Communications and Telecom Single Market Household Survey. March 2014: [http://ec.europa.eu/public\\_opinion/archives/ebs/ebs\\_414\\_en.pdf](http://ec.europa.eu/public_opinion/archives/ebs/ebs_414_en.pdf)

**4.4.2-4.4.5:** We agree with BEREC's analysis in each of these paragraphs (covering the level of aggregation of products, bundles, revenues/retail price, and promotions/temporary discounts), but **ECTA requests BEREC to put more emphasis in its final Guidance on conclusions and best practice triggered by the analysis in each of these paragraphs.** They are key paragraphs for guiding NRAs, which, in the draft Guidance document as it stands, are not given the prominence they deserve, notably due to cross-referencing to a more descriptive section of the document. With regard to discounts (temporary and other), we reiterate that these are widely practiced. We urge BEREC to ensure that all NRAs are confident to address SMP operators' prolongations of the reduced price component of their retail promotions, rolling-over retail promotions, retail gifts and cashbacks, etc.

## **E. Comments on Section 5: Procedural and transparency issues**

**5.1 para 2:** We agree with the 'trigger events' listed, but we suggest adding the following elements: (i) the intended launch of a downstream (wholesale or retail) product or bundle, notified to the NRA as per an ex-ante pre-notification obligation, (ii) the announced future launch of a wholesale or retail product, (iii) the prolongation of a promotion, and (iv) the roll-over of one promotion into a subsequent promotion. We also reiterate that NRAs' ex-ante margin-squeeze tests should be complemented by ex-post checks by the NRAs, in order to verify that the assumptions the NRA made at the time of the ex-ante test were effectively correct. This is important, because judgment calls usually have to be made by the NRA about expected take-up, traffic volumes, effects of promotions (and prolongations and roll-overs of promotions), customer lifecycles, etc.

**5.2 and 5.3:** We find this section lacking in terms of identification of best practice and provision of guidance. **ECTA believes that both pre-notification and ex-ante authorisation of downstream products/bundles is essential, and requests BEREC to identify these as best practice.**

**5.7, last para:** With regard to confidentiality of parameters, we ask BEREC to elaborate on whether this concerns the parameters themselves, or the values used in application of specified non-confidential parameters (e.g. the monthly bandwidth consumption for a broadband service). ECTA believes that the parameters themselves should not be kept confidential, to avoid undermining stakeholders' confidence in the ex-ante margin-squeeze testing process. In addition, ECTA proposes that BEREC should identify as best practice that:

- (i) NRAs make their full margin-squeeze model available to stakeholders. This can be done by removing values deemed to be confidential and substituting dummy values. Access to the full model enables interested parties to see the relationship between contributing parameters (e.g. treatment of churn as a proxy for life time of the customer) and is critical for understanding the robustness of the approach taken; and,
- (ii) NRAs are fully transparent in their approach to determining cost or revenue values in the absence of an observable value. See for example, Ofcom's recent practice, which enabled stakeholders who have experience in such matters to comment and assist in the refinement of the approach.



**5.8:** We agree with the conclusions put forward by BEREC in this section, although we find them limited in scope. We ask BEREC to be more affirmative in identifying best practice.

#### **F. Section 6: Margin squeeze in the context of competition law - differences with the ex-ante approach**

Section 6 of BEREC's draft Guidance document consists of a description of the ex-post regime. This requires no substantive comments from ECTA.

We do wish to make two requests:

First, we ask BEREC to make it clearer that **Table 1 contains a description which is specific to Annex II of the 2013 EC Recommendation** (i.e. not a general description of ex-ante margin-squeeze test standards and practices), e.g. by adding a title to Table 1 and by changing the title of the column "*Regulatory Authorities*" to "*2013 EC Recommendation*".

Secondly, we find it surprising (last para of page 48; right column middle of page 50) that BEREC seems to accept uncritically an assertion that market foreclosure strategies would foster demand for NGA-based retail services and that retail prices would be lower if there were less competition. There is no evidence at all to support this. **We ask BEREC to remove or strongly qualify these points.** Quite to the contrary, there is clear evidence that competition delivers the best deal to users, which is what drives take-up by users, fostering a virtuous cycle including genuine efficient investment incentives by all market participants.

#### **G. Comments on Section 7: Conclusions**

We agree with the entirety of the contents of this section. We specifically welcome BEREC's statement to the effect that the ERT contained in the 2013 EC Recommendation is a "lighter test" than a rigorous ex-ante margin-squeeze test, which is a test which has proven to be necessary to preserve competition alongside other remedies, including (cost-oriented) price controls. We specifically welcome the last sentence of this Section, in which BEREC indicates that NRAs remain the ultimate decision-makers with regard to which form of ex-ante margin-squeeze testing is mandated, and with regard to the detailed application of the test.

We express regret that BEREC has not included an explicit list of best practices for rigorous ex-ante margin-squeeze testing in this document, and we observe that fairly little guidance to NRAs is provided, in a document entitled 'Guidance document'. **ECTA therefore requests BEREC to revise the document, to include clearly identified best practices.**

## **Annex**

Presentation by ECTA at BEREC Stakeholders Event of 16 October 2014.