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BoR PC05 (14) 05

Bonn, 24.10.2014

Deutsche Telekom Group Response on the BEREC consultation on the Economic Replicability Test [1]

Deutsche Telekom takes note of the intention by BEREC to interpret and clarify the Commission recommendation on consistent non-discrimination obligations and costing methodologies ("the Commission Recommendation") with regard to the economic replicability test (ERT) in the present consultation document.

The aim of the Commission recommendation, which was published as part of a package of Commission documents on the Telecoms Single Market in September 2013, is to establish more flexibility for the network operator investing in NGA, thereby enhancing broadband investment while continuing to promote competition in the market.

Deutsche Telekom has a number of concerns with regard to the interpretations and guidance BEREC proposes, as they run contrary to the stated objectives of the Recommendation.

Scope of application of the Economic Replicability Test

First we would like to briefly discuss BEREC's interpretation, that the ERT is primarily used in cases without cost-orientated price-regulation and therefore not necessary in a market with regulated wholesale products. In face of increasing infrastructure-based competition, and taking into account the removal the remaining retail-market in the new list of relevant markets of the Commission, a strong ex ante remedy as the *ex-ante* economic replicability test (ERT) is clearly not appropriate where price controls remain for one or more wholesale products in the market.

[1] ex-ante margin squeeze test for NGA under the Commission costing and non-discrimination recommendation

In markets where the specific conditions of the recommendation do not apply, therefore *ex post* control of margin squeeze based under competition law principles is sufficient. The objective of the recommendation was clearly not to introduce additional regulatory burdens for undertakings investing in NGA.

Parameters of the Economic Replicability Test

However, if an NRA identifies an ex-ante ERT as the right remedy to promote competition and enhance investment it has to choose the appropriate methodology which safeguards incentives for investment in high-speed broadband infrastructure by ensuring pricing flexibility for network operators, and which takes into account the structure of the market in question, the conditions of competition and the relevant elements of the product portfolio.

We therefore would like to comment on some of the specific parameters analyzed by BEREC as follows:

<u>The level of efficiency</u>
The EEO-Test, as stated in Annex II of the Commission recommendation, is the right method to generate a calculation of an efficient operator.

We do not agree with variable adjustments for smaller scale of access seekers allowed in the Recommendation and approved in the draft BEREC Guidance, however. The REO approach, which builds the test based on a smaller scale of access seekers, is mainly used when introducing competition and not in markets where competition is well established or which have a long-term tendency towards effective competition. The adjusted EEO as well as the REO approach introduce scope for arbitrary access and do not support efficient entry. They are moreover based on data from alternative operators, which has not been verified or audited, and is therefore potentially less transparent.

Additionally, adjustments for inefficient (e.g. legacy costs) or economical (e.g. taxation specific to infrastructure ownership) circumstances of the SMP-operator are not taken into account in the consultation document. To not foresee efficiency adjustments in such circumstances leads to higher and economically inefficient prices as well as a disadvantage towards other unregulated and more efficient players. An NRA has the possibility to define a reference operator in a way which excludes inefficiencies and to consider further circumstances. Therefore, such efficiency adjustments have to be reflected. This should be even more the case if adjustments to the EEO standard to account for lower economies of scale of the access seeker are considered admissible. .

<u>The relevant downstream cost standard</u>

BEREC proposes to use a Bottom Up-LRIC+ standard for defining the relevant costs of an efficient operator. We do not believe this cost standard is appropriate for the ERT, even if the Recommendation favours this approach.

The aim of ERT is to avoid misuse of market power and resulting foreclosure of retail markets. To control abusive behavior, the avoidable cost standard is the usual cost standard used in competition law cases and should also be used for ERTs. The ERT does not have to fulfill the task to define a price of a monopolistic operator, but controls a market where competitive pressure from competing infrastructures exists and parallel NGA infrastructures by several network operators are often present. In such circumstances, legacy infrastructures might under certain circumstances still be used to leverage market power to new markets, which the ERT is meant to avoid. To set the right investment incentives in line with the recommendation’s objectives, however, NRAs should not limit the pricing opportunities of an NGA investor by using a cost standard adopted for margin squeeze tests on the legacy infrastructure such as LRIC +. In this context it is worth noting that the initial Commission proposal for the Recommendation recommended the use of an avoidable cost, standard which was only later changed to LRIC +.

We agree with the BEREC draft report and the Commission Recommendation that the relevant wholesale price is the price effectively charged including volume discounts and long-term agreements. Although the SMP operator is able to undertake different risk commitments, the ERT should be based on his own risk following the assumption that an efficient access seeker would commit to the same risk elements as the investing NGA network operator. Since there are various risk sharing models throughout Europe (from Joint Ventures to build common infrastructures to simple economic commitments such as upfront payments) the parameters and the structure of an ERT should reflect the risk of the investing NGA network operator and not lower commitment-models or options without any shared risk of inefficient access seekers. The ERT therefore has to be executed differently depending on the details of the risk sharing model in place.

Relevant wholesale product

We agree with the approach of carrying out the test on one most relevant access product, but we do not agree with the interpretation provided by BEREC that an individual mix of different legacy and NGA products is the appropriate method to use. An efficient access seeker would offer the newest technology to be one of the most innovative suppliers, so he needs only the new NGA access where it is available. Hence the efficient wholesale product is the most relevant NGA access product. The lowest step of the ladder of investment seems best placed to enhance investment and promote infrastructure competition, so the unbundled local loop (ULL) -market must be the relevant anchor.

The relevant time period

We are fully in line with the DCF-approach which is foreseen in the recommendation. The ERT has to base the calculation on the same principles the access seeker would use for his investment decisions, as only this equal treatment enables the regulated operator to act flexibly and offer competitive retail prices, which in turn supports the aim of investment in NGA networks. Usually business cases are based on wholesale product lifetime and long run calculation models to make investment decisions based on underlying assumptions on future costs and revenues. The investing NGA network operator will have a disadvantage, if he is not able to offer flexible pricing models and calculate the costs and profits over the complete lifetime of the investment.

The relevant retail product

The BEREC guidance does not correctly interpret the Commission Recommendation with regard to the relevant aggregation of retail products in the ERT. The Recommendation says "NRA should assess the most relevant retail products including broadband services (flagship products´)" (Annex II (iv)), so that it should be clear that the ERT has to calculate a portfolio

of retail products. Even BEREC identifies that the product-by-product method would not allow much flexibility for competitive retail offerings for NGA network operators (S.25) and in fact less incentives to invest. The conclusion is obviously to use a portfolio of retail products for the ERT which includes current products with new and existing customers, bundles, innovative variations with the potential for flagships and niche products.

For the calculation of the value of the portfolio NRAs have to take into account the usual business model of competitors of the investing NGA network operator. We agree that this may include discounted prices, but in cases of short or regional promotions they have to be weighted with the non-discounted prices of the portfolio. An early ex-ante communication of discounts to the NRA, as described on Page 36 of the BEREC draft guidance, would prevent the commercial flexibility and an adequate time-to-market of our products and therefore discriminates the investing NGA network operator. An ex-post control is sufficient if the NRA makes the parameters of an ERT transparent beforehand.

We also agree that all relevant revenues of downstream services attributable to the bundle have to be taken into account. Non-regulated services are also part of bundles which are typically realized in the market. This includes of course directly revenues like traffic or calls but also options and services like VOD TV offerings, Router, safety-packages or cloud-services. A competitor takes all this revenues and costs into account and might calculate a lower monthly signal-price for the bundle because he gets high revenues with additional services. An efficient operator would calculate with the revenues of the average typical usage of a customer and the production costs for these services. Because most of the NRAs, as the questionnaire shows, are not familiar with unregulated components like content rights, any calculation in this area has to be made carefully.

Geographical segmentation

The Recommendation and BEREC's draft guidance allow for geographically differentiated sub-markets and remedies. To be in line with a portfolio test of the SMP operator, the different sub-markets should be weighted to create an efficient nation-wide access seeker. Only an appropriate mix of geographic and temporary prices of products in view of a portfolio allows a flexible pricing strategy as mentioned in the Recommendation and the draft BEREC report as an aim.