



BoR PC05 (14) 06

**KPN response to the
Consultation on the draft BEREC Guidance on the regulatory
accounting approach to the economic replicability test**

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GENERAL REMARKS

Introduction

KPN welcomes the opportunity to comment on the draft Guidance published by BEREC. In this submission we will only highlight some specific issues, mainly in relation to the competitive situation in the Dutch market. For a more in depth comment we refer to the ETNO position in this consultation, which we fully support.

The issue of ex ante margin squeeze regulation has historically been a core instrument of telecoms regulatory intervention. Most of the application of margin squeeze tests has been defined in periods – and for single product markets – that were more or less stable and homogenous. In the context of the current consultation, it should be noted, however, that many of the relevant factors of application of an ex ante margin squeeze test are nowadays much more complex.

The consulted ‘Guidance’ seems to be of a descriptive nature, at this stage, rather than concluding on recommended practices to support the goal of the *Commission Recommendation on consistent non-discrimination obligations and costing methodologies (2013/466/EU)*. The overriding aim of the Recommendation is to create a regulatory environment that fosters the investment in NGA networks. Previous regulatory paradigms concentrated to a large extent on lowering barriers for service competition (often price competition), whereas the uncertain nature of investment in NGA networks requires a much broader approach. We would urge BEREC to promote interpretations that reflect the goal of the Recommendation.

It should be stressed that the development of NGA networks in the European Union shows much more national and regional differences than in other segments of the telecommunications market. In some countries and regions the overriding public policy issue should be to create an investment (and competition) climate necessary to have at least one NGA network available to connect a customer. In other countries and areas for the majority of customers already one or more NGA networks are available. Mobile 4G networks will increasingly add to the availability of competing NGA networks.

In case of network competition ex ante margin squeeze tests are not a proper instrument

For markets where nationwide network competition exists between cable- and copper-networks (such as the Netherlands, Belgium and Malta) consumers already have choice today for the supply of broadband subscriptions, between at least two networks and (on the copper or FttH networks) a variety of service providers. It is important to note that in these countries the cable networks are operated on the basis of one worldwide technology (DOCSIS), which allows standardised high quality/high speed broadband access, offered by vertically integrated operators. The copper networks have been operated under strict access regulation, which did not allow the same level of freedom to upgrade networks, migration to next generation technologies (including fiber/FttH), pricing flexibility, etc. In the Netherlands cable/DOCSIS networks already have become the dominant broadband technology. The aim of any further regulation should therefore not be ‘the conditions to allow access to the incumbents network and how to create investment potential even with regulated access’, but should be ‘how to create a level playing field between cable/DOCSIS and copper/fiber networks in such a way that the current competition is not endangered’.

We understand that it is not the subject of this consultation to provide guidance on the market definitions and dominance analyses in such markets. Practice indicates however, that it cannot be excluded that even in such competing (NGA) network markets, NRA’s sometimes view regulated access as a necessity. If such an NRA would even impose forms of

price regulation (including potential ex ante margin squeeze tests), it will even be more complex to strike the right balance to define the applicable parameters. Since the cable/DOCSIS operators may have less investment needs to upgrade to higher speeds, they will be able to offer low retail prices for broadband services. DSL/FttH based operators that want to compete with these cable retail services should be able to offer comparative retail tariffs in order to maintain a sufficient level of competition. Where such operators invest in FttH networks, or copper upgrades, in order to meet competitive service and speed levels, the investments (especially for FttH) are large and the potential demand hard to define. An incorrectly defined ex ante margin squeeze test will squeeze potential competition to the cable operators out of the market: if the incumbent cannot use retail pricing instruments to attract sufficient demand to justify the investment, competition with cable might be unduly restricted. This cannot be remedied by lowering the associated wholesale rates under the levels to justify the investment. Therefore retail pricing flexibility that allows the flexibility 'to test price points and conduct appropriate penetration pricing' (BEREC consultation document, p. 7) is a requirement. Ex ante margin squeeze tests (ERT) should not restrict by any direct or indirect means retail pricing flexibility. If safeguards would be needed at all, they should be sought at much higher levels and – at most, if dominance would be found – on an ex post basis.

Similar conclusions for business markets

Not only in consumer markets, on which cable operators historically started offering their broadband services, but also in business markets the developments to more competing networks and services are ongoing. Although initially the business services markets development seemed slower, currently in many countries alternative NGA network investment is rapidly developing. The fact that this network competition is more fragmented than in cable consumer markets – alternative networks are often local, by a variety of investors (cable, alternative national operators,¹ local commercial operations, local public operations, etc.) – the economic rationale to enable pricing flexibility is inherently the same.

Concluding

In (national or regional) markets where network competition is effective, a finding of single or joint dominance is increasingly unlikely and remedies decreasing pricing flexibility – such as an ERT – create a risk of endangering this competition, rather than promoting it.

KPN urges BEREC – first of all – to review whether an ex ante margin squeeze test/ERT as such is an appropriate regulatory tool in such markets (especially if only one of the geographically competing networks would be regulated). If there would be a justification – which we question – than there should be an implementation that takes into account the need for the maximum flexibility in retail pricing needed for competing with unregulated vertically integrated (cable) competitors.

SOME MORE DETAILED REMARKS TO THE CONSULTATION DOCUMENT

Starting point: no ERT in case of regulated wholesale prices

KPN recognises the BEREC conclusion that where price control mechanisms on the relevant wholesale inputs are in place no ex ante margin squeeze tests or ERT should be imposed.

¹ Such as in the Netherlands Eurofiber.

Consultation document - Section 4.1.2 ('Efficiency'):

[The conclusion of the stated definitions from the Recommendation as well as the current practice of NRAs would therefore be: The majority of NRAs use the REO/adjusted EEO test as the preferential level of efficiency while the Recommendation starts with the EEO test, but allows scale adjustments if the SMP operator has frustrated the market entry or where very low volumes of lines and their significantly limited geographic reach as compared to the SMP operator's NGA network indicate that objective economic conditions do not favour the acquisition of scale by alternative operators. – BEREC, p. 31.]

In light of the introduction, for markets with full network competition KPN considers it more appropriate to use a 'Most Efficient Operator' as reference, instead of an 'Equally Efficient Operator'. When competing network operators have lower cost structures, the ERT should take this into account giving the SMP operator the opportunity to be competitive and reach a higher level of efficiency in future. This is for example necessary where the SMP operator competes with vertically integrated network competitors, such as cable companies.

Consultation document - Section 4.4.3 (bundles):

[The Recommendation establishes that bundles need to be considered in the ERT, especially when they constitute "flagship products". The definition of bundles subjected to the margin squeeze analysis is not limited to those bundles which consist only of regulated components. From BEREC's point of view, if bundled products are relevant in the market, they need to be included in the analysis and in any case all bundles containing regulated services are subject to the test. – BEREC, p. 35.]

According to KPN the term 'bundles' needs to be clearly defined. A guideline is 'a contractual or financial relation' between the different products in a bundle. In this case the complete bundle should be tested on margin squeeze with respect to the regulated products. On the other hand, if there is only a loose relation, for example combined usage, such as the usage of cloud services over a network connection, then these products should not be treated as a bundle.

Consultation document - Section 4.4.5:

[BEREC therefore considers that in order to test the replicability of a bundle or standalone service such discounts and promotions should be taken into account in the margin squeeze test, but NRAs should have flexibility on how they take them into account (e.g. on the revenue or cost side), because the nature of the promotions/discounts and the strategies of the SMP operators incl. the competitive effects can be very different according to the level of development of the retail market or the national circumstances in general. Acc. to the BEREC report on specific aspects of broadband commercialization, NRAs should check whether "the SMP operator offers at the wholesale level to its own retail arm are the same than those offered to third parties and if these conditions do not threat competition in the retail market", thus ensuring a level playing field. – BEREC, p. 36.]

According to KPN sufficient flexibility should be provided for temporary discounts and promotions. In the BEREC guideline the pay back of promotions is related to the services involved. Instead, it should be possible to earn back the promotions on the total customer base and over a longer time period than the customer lifetime.