BoR PC05 (14) 07

To: **BEREC**
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Subject: Contribution to the Public Consultation on the Draft BEREC Guidance on the regulatory accounting approach to the economic replicability test (i.e. ex-ante/sector specific margin squeeze tests) [BoR (14) 123]

Fastweb, one of the leading broadband operators in Italy, welcomes the opportunity to comment on BEREC's draft Guidance on the regulatory accounting approach to the economic replicability test (i.e. ex-ante/sector specific margin squeeze tests).

Fastweb agrees with BEREC on the necessity to provide NRAs from the regulatory accounting point of view with a tool enabling them to understand and run the ex-ante economic replicability test according to Annex II of the Recommendation on consistent non-discrimination obligations and costing methodologies (hereafter "the 2013 Recommendation").

We share BEREC's view that the economic replicability test is a key instrument to preserve competition. We want to stress that in order for such a test to be effective and preserve competitors from margin squeeze practices, not all methodologies achieve the same result. Although we share the view that, as for many other regulatory remedies, there is no one size fit all approach, we believe that a more specific guidance on the effective methodologies based on best practices may be advisable to ensure that tests are run in a way to guarantee a robust safeguards to competition.

Also, we invite BEREC to pay attention to procedural and transparency issues as they are extremely relevant in order to provide all players in each market equal capability to protect their interests.

In order to get support on the most effective methodology, Fastweb - in January 2014 - commissioned Oxera an independent assessment on the existing Italian margin squeeze test as well as guidelines on how the test could be modified to ensure its consistency with the best regulatory practice and the 2013 Recommendation. It is worth noting that Oxera's report – that we attach - widely supports the position of BEREC's Guidance on many aspects, as it will be developed further.

Finally, Fastweb fully agrees with BEREC on the non-substitutability of non-discrimination remedies (including the ex-ante margin squeeze testing) with the one of price control as they serve different purposes. Furthermore, Fastweb requests BEREC to support the preservation of such tests on copper-based products as its application is completely independent from technology and from the absence of price control and its objective is safeguarding non-discrimination and competition. **We would suggest BEREC to further emphasize these principles in the introductory and in the conclusion parts of its Guidance.**

The BEREC draft Guidance on the economic replicability test analyses the parameters that it believes to be necessary when implementing a margin squeeze test which are by the way wider than the one listed in the 2013 Recommendation.
Fastweb will analyse only a few parameters considered in this Guidance and focus more on the procedural and transparent issues which are, considering the Italian situation, extremely relevant for the company indeed.

<u>Downstream costs</u>

Regarding the downstream costs, the draft BEREC Guidance reports that the majority of the NRAs are estimating these costs on the basis of a REO/adjusted EEO methodology, while the 2013 Recommendation suggests the adoption of the EEO test, allowing, however, the NRAs to make some adjustments for scale to the EEO test in the following cases: i) "*when entry or expansion has been frustrated in the past* or ii) *a market where low volumes of lines and their significantly limited geographic reach as compared to the SMP operator's NGA network indicate that the objective economic conditions do not favour the acquisition of scale by alternative operators*"[1].

Fastweb invites BEREC to further stress the superiority of the REO/EEO adjusted test for evaluating the downstream costs as it takes into account the scale and scope disadvantages faced by Alternative operators and assesses carefully technical, legal, regulatory barriers, such as the operator's positions on other markets (wireless or mobile communication).

<u>Relevant cost standard</u>

The 2013 Recommendation specifies that the appropriate cost standard for the relevant downstream service is the incremental cost which should be calculated on the basis of the BU-LRIC+ model. The use of the BU-LRIC+ approach is particularly important as it allows Altnets to compete on a level playing field with the SMP operator on retail markets.

[1] Recommendation on consistent non-discrimination obligations and costing methodologies, Annex II, par. (i).

As regard to the cost of non-regulated inputs, Fastweb underlines the importance of evaluating these costs using the available information on costs actually borne by alternative operators or, alternatively, on estimates based on European benchmarks.

As far as the estimation of "retail costs" is concerned, Fastweb endorses the position of the draft Guidance and highlights the need **of introducing clearly identified best practices in order to give indication to NRAs in terms of, for example, cost categories to be included in the retail costs** (e.g., marketing costs, customer acquisition and care, billing, bad debt, CPE cost and distribution, product development and management) **or in the common costs, as well as providing for instruments to evaluate each elements.**

<u>**Relevant wholesale input**</u>

The 2013 Recommendation suggests that the economic replicability test is conducted "*on the basis of the most relevant regulated input identified at the chosen NGA-based wholesale layer*"[2].

According to BEREC, in the choice of the relevant wholesale access products, it is important to take into account the change of the mix of legacy and NGA access products over time, as given the relatively recent migration to NGA services, the weighting of the NGA inputs could initially be fixed and based on the assumption that customers still served via LLU and via line sharing will probably all migrate progressively to an equivalent NGA wholesale product.

Fastweb agrees in principle that the NRA identifies the most relevant regulated input. It should be noted though that, at least in the initial stage, and in consideration of the fact that the market for NGA-based broadband offers is at its initial stage, **it is advisable to test the replicability of the offers against the less infrastructure-based wholesale input, such as NGA bitstream, in order to avoid the exclusion from the market of new entrants**. Alternatively, only the operators already having a sufficient level of infrastructures are capable of replicating the commercial offers of the incumbent.

<u>**Time period**</u>

The 2013 Recommendation states that profitability should be evaluated on the basis of a dynamic multi-period analysis (the DCF approach) and that the relevant period for the ex-ante economic replicability test should be set on the basis of the estimated average customer lifetime.

BEREC considers that the choice of the profitability assessment methodology should be left to each NRA while the relevant period for running the test should be the one provided by the 2013 Recommendation. Nevertheless, BEREC highlights that for estimating the average customer lifetime it is not adequate to use data on NGA broadband market if the launch of such products is relatively recent.

[2] Recommendation on consistent non-discrimination obligations and costing methodologies, Annex II, par. (iii);

Fastweb agrees with BEREC and points out that **introducing the data coming from NGA market in the evaluation of the lifetime could alter the result since such data are extremely volatile**. As BEREC correctly underlined the calculation of the customer's lifetime could be affected by the volatility in early stages of market development of churn rates and by the minimum contract terms "blocking –in" literally customers for a certain period of time.

Instead, Fastweb considers that there are no reasons why the assessment of the average customer's lifetime should be done differently in the ultra-broadband market as it is done in the broadband market, as the features of the services and behavior of the customers could be considered similar.

Relevant retail products

The 2013 Recommendation provides that the ex-ante economic replicability test should be run only on "*flagship products*" to be identified by NRAs "*on the basis of their current and forward-looking market observations, in particular taking account of current and future competition*"[3].

BEREC is of the view that the bundle should be considered also as "*flagship products*", if relevant for the market. Furthermore, BEREC underlines an inconsistency between the time prescribed by the Recommendation to launch and terminate the procedure of the test and the provisions on the "*flagship products*". According to BEREC, it could be difficult to assess whether a product could be qualify as being or not a "*flagship products*" in the three first months following its launch due to the difficulty of such an assessment[4].

Fastweb fully supports the BEREC position. In particular, Fastweb would like to emphasize that it is very complicate to foresee in advance if a product could be qualified as "*flagship products*" or not.

Furthermore, considering the complexity to assess in advance the volume (and therefore expected revenues) connected to each specific promotion, Fastweb highlights that it is extremely important to assess the replicability of each promotion through a specific product-by-product test rather than simply through the DCF test, in order to avoid cross-subsidiary effects or infringement due to wrong volume's assessment.

Fastweb invites BEREC to stress the relevance to complement the ex-ante margin squeeze test with an ex-post check by NRAs in order to verify that the assumptions the NRAs made at the time of the ex-ante replicability test (in terms of volumes and therefore of overall revenues connected to the offer) were correct. This additional test should assess all new offers launched by the SMP operator on a stand-alone basis over a defined period (the customer lifetime). As suggested by Oxera this ex-post check "*would also enable the Italian NRA to audit and verify more easily the accuracy of the information provided by the incumbent, as the data should be consistent with the information contained in its regulatory and/or managements accounts*"[5]

[3] Recommendation on consistent non-discrimination obligations and costing methodologies, recital 66 and Annex II, par. (iv);
[4] Recommendation on consistent non-discrimination obligations and costing methodologies, Annex II, par. (iv);
[5] Economic assessment of AGCOM's ex-ante margin squeeze test, Oxera, 23.01.2014, page 4;

Fastweb is of the view that in markets with a track record of discrimination and abusive behavior where more structural solutions such as functional separation have not been introduced and in order to counterbalance the asymmetry of information between the NRA and the SMP operator, it may be advisable to suggest to NRAs the introduction of an additional ex-post test, on top of the standard ex-ante DCF test as a further tool to check the accuracy of information provided to the NRA by the SMP operator [6].

Procedural issues

The 2013 Recommendation states clearly the procedure that NRAs have to follow to run the ex-ante economic replicability test. The procedure begins normally with a "trigger event "as the launch of a new retail offers or on NRA's own initiative or furthermore at the request of third parties. It has to start not later than three months after the launch of the retail offers and must be concluded within four months. However, the 2013 Recommendation does not mention any obligation by the SMP operator to notify upcoming retail offers well before their launch.

BEREC considers that such an obligation should be imposed on the SMP operators by the NRAs only in case of the launch of a new retail offers.

Fastweb agrees with BEREC and invites it to specify that NRAs should put in place **detailed procedural rules regarding the obligation to notify to NRA the launch of the retail offers, as well as clarify that the authorization has to be explicitly given by the NRA and adequately publicized.**

Transparency issues

The 2013 Recommendation provides specific indication as far as transparency is concerned. Specifically it foresee that the procedure and the parameters that shall be applied to the test should be set out and made public in advance by the NRAs; the test should be adequately detailed and should include a set of relevant parameters to ensure predictability and transparency for operators and finally all the details and the roadmap of the test should be published in the NRAs websites.

In the current practice, not all NRAs fully disclose the parameters used in the test, and do not make available the electronic model used to run the test.

Fastweb invites BEREC to stress the necessity to increase the degree of transparency and to make the electronic model (i.e., Excel file) adopted by the NRAs for running the test available to all stakeholders, not only the SMP operator.

It is worth noting that the Oxera report emphasizes these issues and proposed to increase the overall transparency and consistency of the test by making public the following parameters of the test: i)"*how*

[6] See also the paper of Oxera, page 5.

reasonable return of capital is accounted for in estimating the downstream costs; ii) how the regulatory accounts and the Reference Offer are used to measure the network costs related to the non-regulated network component of the test; iii) what the different levels of aggregation (or "families" in the DCF portfolio test) are; iv) what revenues and costs are included in the wholesale, non-regulated and retail components in each test; v) how the Italian Authority verifies the accuracy of the forecast data provided by the test; vi) what action or regulatory remedies are envisaged if case of the SMP operator is failing one or more of the test"[7].

Annex : Economic assessment of AGCOM's ex-ante margin squeeze test, Oxera, 23.01.2014

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About Fastweb

The main fibre-investing challenger in the Italian broadband market, Fastweb, was a pioneer in the deployment of fibre in Europe, being the first operator to deploy a FTTH network to cover 7 urban areas and more than 2.0 million customers. 15 years after its establishment, Fastweb is still the broadband operator that invests most in fibre deployment in Italy.

Where it has not been able to roll out FTTH, Fastweb has deployed its fibre up to the central office of the former national monopolist and has served its customer base through LLU, i.e. by leasing the last mile of the telecom incumbent legacy access network. This has proved to be a winning strategy because thanks to the end-to-end control of the network, Fastweb has been able to innovate introducing ever higher speeds and innovative services, in most cases well in advance of the former monopolist. In 2013 Fastweb launched a €400 million investment plan to further expand its proprietary NGA through a fibre-to-the curb (FTTC) network. Thanks to this new investment, Fastweb's NGA coverage will reach 5.5 million households before the end of 2014. Very recently, Fastweb confirmed it commitment to develop and alternative fibre infrastructure in Italy by expanding its development plans to 100 cities, reaching 7.5 million households by the end of 2016, thus significantly contributing to the achievement of the targets of the Digital Agenda for Europe.

Fastweb's history is the evidence that infrastructure-based competition is vital in delivering welfare to consumers and high fibre-based quality services to SMEs, larger corporate clients and public administrations.

[7] Economic assessment of AGCOM's ex-ante margin squeeze test, Oxera, 23.01.2014, page 5;