BoR (13) 171

BEREC Opinion on

Phase II investigation

pursuant to Article 7 of Directive 2002/21/EC as amended by Directive 2009/140/EC:

Case FI/2013/1498

Wholesale markets for call termination on individual public telephone networks provided at a fixed location (Market 3) in Finland

29 October 2013

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1. EXECUTIVE SUMMARY

On 2 September 2013, the Commission registered a notification by the Finnish Regulatory Authority, Viestintävirasto (FICORA), concerning the review of the wholesale markets for call termination on individual public telephone networks provided at a fixed location in Finland.

In the draft measure, FICORA proposes to lift all obligations on the markets for call termination provided at a fixed location as regulation is no longer justified as the SMP status of all fixed operators should be lifted. Operators are expected to be sufficiently and effectively disciplined through the retail market.

On 2 October 2013 the Commission sent a serious doubts letter opening a phase II investigation pursuant to Article 7 of Directive 2002/21/EC as amended by Directive 2009/140/EC. The Commission's serious doubts concern the SMP assessment and the creation of barriers to the internal market.

On the basis of the economic analysis set out in this Opinion, BEREC considers that the Commission's serious doubts are justified.

2. INTRODUCTION

On 2 September 2013, the Commission registered a notification by the Finnish Regulatory Authority, Viestintävirasto (FICORA), concerning the review of the wholesale markets for call termination on individual public telephone networks provided at a fixed location in Finland. On 10 September 2013, a request for information (RFI) was sent to FICORA, and a response was received on 13 September 2013.

The Commission initiated a phase II investigation, pursuant to Article 7 of Directive 2002/21/EC as amended by Directive 2009/140/EC, with a serious doubts letter on 2 October 2013. In accordance with the BEREC rules of procedure the Expert Working Group (EWG) was established immediately after that date with the mandate to prepare an independent BEREC opinion on the justification of the Commission's serious doubts on the case.

On 4 October 2013 the EWG sent a list of questions to FICORA. Answers were received from FICORA on 7 October 2013.

The EWG met on 10 October 2013 in The Hague. During this meeting the EWG held an interview with FICORA to gather further information and clarification in response to the questions sent the week before and to ask additional questions. The objective of the EWG was to reach clear conclusions on whether or not the Commission's serious doubts are justified.

On 16 October 2013 the Commission sent another RFI to FICORA. FICORA's response to this was received on 21 October 2013. FICORA's response to the Commission's second RFI was not assessed by the EWG before finalising the Opinion given that it was too late in the process.

A draft opinion was finalised on 25 October 2013 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 29 October 2013. This opinion is now issued by BEREC in accordance with Article 7(5) of the Framework Directive.

3. BACKGROUND

Previous notifications

The previous review of the fixed termination markets was notified by FICORA on 26 October 2007. FICORA stated that 35 telecommunications operators had significant market power in the market for call termination on its own public telephone network. The following remedies were imposed: interconnection, transparency, price control (cost-orientation and non-discrimination), cost accounting and accounting separation. The Commission commented on the cost-orientation and cost accounting obligations expressing concerns regarding the freedom left to each operator to select the cost-accounting model it wishes to use. Furthermore, the Commission stressed the need for a coherent European approach and invited FICORA to revisit its analysis as soon as a common approach was established at European level.

Current notification and the Commission's serious doubts

Current notification

In the current notification FICORA proposes to lift the SMP status of all fixed operators, thereby lifting all obligations. Operators are expected to be sufficiently and effectively disciplined at the retail level.

FICORA first analysed the substitutability of voice services in the retail market and considered that mobile subscriptions and fixed subscriptions (including VOIP) are substitutes. Therefore, calls made from mobile subscriptions are considered to be substitutes for calls made from fixed telephone subscriptions.

The main considerations for FICORA to conclude that fixed operators will be disciplined through behaviour at the retail market level are:

- The costs incurred from switching from fixed to mobile telephone subscriptions cannot be regarded as significant, taking into consideration that it is much less expensive to use a mobile subscription than a fixed subscription.
- The availability of mobile is at least as good as the availability of fixed telephone subscriptions. Almost everywhere in Finland end-users can select a telephone subscription from at least one fixed network operation and three mobile network operators.
- The majority of end-users in Finland have switched to using mobile services only. Also, 98-99% of residents and 96% of non-residential customers have one or more

mobile telephone subscriptions; only 7% of fixed telephone subscribers do not have a mobile subscription.

Following its analysis of substitutability at the retail level, FICORA analyses countervailing buying power in the wholesale market for fixed termination and maintains that an increase in the wholesale call termination price would lead to the substitution of calls away from the network that raises wholesale call termination charges, and this would sufficiently constrain FTRs to the extent that a rise in FTRs would be unprofitable.

Commission's serious doubts

In the present case, FICORA concludes that an increase in the wholesale call termination price would lead to the substitution of calls away from the terminating network (that raised wholesale call termination charges), which would exercise a sufficient constraint on FTRs, thus making a FTR rise unprofitable. FICORA's conclusion is based on the assumption that an increase in FTRs would translate to higher retail prices, since competing retail operators would not be able to absorb such an increase. According to the Commission, FICORA has not provided a sufficient quantitative analysis supporting this assumption. FICORA's approach does not follow point 78 of the SMP Guidelines according to which, before coming to a conclusion as to the existence of SMP, NRAs should undertake a thorough and overall analysis of the economic characteristics of the relevant market.

Furthermore, the SMP Guidelines (par. 73) indicates that market power should be essentially measured by the ability of the undertakings to raise prices without incurring a significant loss of sales and revenues.

According to the Commission, FICORA has not provided convincing evidence that demand substitution at the retail level exercises a sufficient competitive constraint to make an FTR increase unprofitable.

The Commission is also of the view that lifting regulation from the fixed voice call termination markets in Finland, where there are doubts that FICORA has provided sufficient evidence to prove that fixed operators would not have SMP, may lead to excessive pricing, which in turn may increase the costs for the provision of fixed services and lower the ability of other operators and service providers (including those established in other Member States) to provide electronic communication services in Finland. Such excessive pricing is incurred at the expense of the operators, and eventually consumers, in the Member States from where the calls originate and where FTRs are regulated.

4. ASSESSMENT OF THE SERIOUS DOUBTS

On 2 October 2013, the Commission sent a serious doubts letter opening a phase II investigation pursuant to Article 7 of Directive 2002/21/EC as amended by Directive 2009/140/EC. The Commission's serious doubts are concerned with whether the SMP analysis proposed by FICORA meets the requirements laid down in Articles 14 and 16 of the Framework Directive, as well as Article 8 (2) (b) of the same directive. These serious doubts stem from the Commission's view as to the lack of reasoned evidence to support the conclusions on the non-designation of operators with SMP. The Commission also takes the view at this stage that the notified regulatory measure would create a barrier within the internal market.

FICORA has not provided convincing evidence that, despite a 100 % market share, operators would not have SMP on the market for call termination on individual public telephone networks provided at a fixed location.

With respect to the Commission's remark that FICORA did not provide sufficient evidence that an increase in FTRs would be translated into higher retail prices, BEREC is of the opinion that this Commission remark is valid. The main question here is how the cost of wholesale inputs (here voice call termination) is reflected in the retail pricing structure of the individual operators. Neither in its market analysis nor in response to Questions 8 and 9 of the RFI did FICORA provide comprehensive information that would support its statement that the increased termination rates would be fully passed through into to the retail prices. In its response to the RFI, FICORA sees no factors that would prevent mobile operators from increasing the retail prices for calls to those fixed networks which increased their FTRs. In BEREC's opinion, in a competitive market like the Finnish mobile market with 3 nationwide mobile operators, mobile operators would likely first try to absorb this FTR increase thereby avoiding an increase in retail prices and thus stay competitive on that market. Furthermore, it might be the case that the call termination input cost is low relative to the overall costs inputs that feed into the final retail price for the consumers. However, FICORA did not present any analysis of the structure of the retail prices and how the retail prices are set having regard to the underlying costs associated with the provision of the retail service.

BEREC shares the Commission's concern about the absence of any quantitative analysis that would demonstrate the impact of increased FTRs on retail prices. Indeed, FICORA presented both in its market analysis and in response to the RFI only qualitative analysis which, in BEREC's opinion, could have been supported by a quantitative analysis demonstrating the extent to which the increase in FTRs is likely to be translated into the retail price.[1]

BEREC fully shares the Commission view that further data is needed to more clearly demonstrate that competitors would not be able to at least partially absorb the FTR increase in their margins rather than passing through the FTR increase entirely to the end-users of retail telephone services. As stated above, given competition in the mobile market it is not likely in the interest of mobile operators to react immediately to an FTR increase by passing it through via an increase of the retail prices. The low retail prices on the mobile market in Finland relative to other EU countries suggest that competition in the mobile market is strong in Finland. In such circumstances, mobile players will likely be conscious of the need to remain competitive on that market and, rather than passing through FTR increase into retail prices, may try to cut some other costs in order to avoid this. In BEREC's opinion, FICORA did not present sufficient evidence that would support its position that an increase in FTRs would be fully passed on to the retail prices of customers calling the network which raised FTRs. BEREC therefore agrees with the Commission's view that a more thorough analysis of

[1] Various methods of simulation could have been done by FICORA which take into account the structure of the retail prices in terms of the weight of the underlying costs for the provision of service, customer's behaviour, their awareness of the prices towards different networks, etc.

the relationship between input costs and retail prices in the Finnish retail market should have been done by FICORA.

One of the key issues highlighted by the Commission's serious doubts letter is that '*while fixed to mobile substitutability (FMS) at the retail level may be at a rather advanced state in Finland, no sufficient evidence is provided to which extent fixed subscribers would effectively switch to mobile subscriptions because of the increase in FTRs, or mobile numbers are called instead of fixed ones*.' BEREC is of the opinion that this comment by the Commission is justified.

BEREC notes that, at the retail level, the extent of FMS in Finland is likely to be somewhat reflected in the 53% decrease in total fixed telephone subscriptions between 2007 and 2012 and the 60% increase in total mobile telephone subscriptions in the same period. In addition, FICORA also illustrates that the volume of calls made from fixed telephones have decreased in the five years to 2012, while mobile telephone volumes have increased in that period. However, while BEREC notes that the Finnish market may be 'ahead of the curve' in terms of the low levels of fixed telephony subscriptions among non-business customers and FMS these factors, in and of themselves, do not necessarily point to an effective competitive indirect constraint being exerted on the mobile termination markets.

BEREC agrees with the Commission that given that each fixed network operator has 100% market share and, having regard to the absence of any effective wholesale demand-side or supply-side substitutes, this raises a strong presumption of SMP. In view of this, BEREC would expect to see clear evidence from FICORA that demonstrates that end-user behaviour has the potential to unambiguously mitigate market power in the fixed termination markets. However, FICORA has not presented evidence or data to highlight that Finland's retail market dynamics are likely to sufficiently mitigate the market power of each of the 31 fixed network operators in the wholesale market for call termination on the public telephone network at a fixed location.

BEREC does not consider that the primarily theoretical analysis presented by FICORA is sufficient to justify the conclusion that *'the significant market power of fixed network operators in the wholesale market for call termination on the public telephone network provided at a fixed location is significantly constrained by the market power created via end users in the retail market'.* No material evidence was presented to show, among other things, the extent to which wholesale FTRs are reflected in retail prices; the extent to which the called party of the terminating fixed network is aware of and sensitive to the costs faced by those calling them[2]; and the extent to which such called parties would sufficiently react to such sensitivities to the costs faced by calling parties by changing their behaviour through switching to alternatives such as a mobile service. Similarly, no material evidence was presented to support the premise that calling party behaviour might act as an effective competitive constraint on the FTR setting behaviour of the terminating network of the called party.

[2] With the FTRs levied by the terminating fixed network being fed through, to one degree or another, into the retail costs faced by the calling party, when making a call.

In this respect, BEREC would note that FICORA has not demonstrated, for example, the extent to which the impact of any increases in wholesale FTRs might be effectively constrained by retail consumer behaviour (subject to the degree to which FTRs are passed through into retail prices) having regard to a number of factors, including the calling party's:

- awareness of the identity of the called party's fixed network operator (which due to fixed number portability may not be possible);
- awareness of the cost of making calls to the called party of a particular fixed network operator;
- sensitivity to such call costs and changes in costs; and
- the extent to which any calling party's changes in behaviour in response to such sensitivities, say through switching to alternative forms of communication or reducing their consumption, might effectively constrain FTR setting behaviour.

A similar analysis of called party's behaviour might also be relevant.

In its RFI, the Commission asked FICORA to *'further clarify why such an [geographic] analysis was not necessary'.* The Commission requested that FICORA *'provide evidence that fixed to mobile substitution takes place all over the country (and is not limited to certain regions only).'* In BEREC's view, FICORA's response did not provide sufficient evidence that fixed to mobile substitution does take place all over the country.

Similarly, FICORA's conclusion on the non-SMP status of fixed network operators seems to be based on a generic, one-size-fits-all indirect constraints analysis for both residential and non-residential segments, when FICORA's own data seems to suggest differences between the extent to which such segments are likely to switch to alternatives. In its serious doubts, the Commission refers to the '*important difference in the shares of residential and non-residential users who have both fixed and mobile subscriptions, respectively 13% and 54%.'* In BEREC's opinion FICORA has not provided sufficient evidence in coming to its conclusion that indirect constraints from the business segment would be effective, particularly given the suggestion that non-residential users maintain both fixed and mobile services given customer service, habits, and the incompatibility of mobile phones with other systems. This suggests to BEREC that certain non-residential users need to maintain their fixed line services and would not be in a position to switch to being mobile only.

BEREC agrees with the Commission that FICORA '*should have analysed the behaviour of those (specifically non-residential) customers*' as the divergent figures of 13% and 54% suggest further investigation of these two segments is warranted. In its market analysis BEREC notes that FICORA did not present the global share of end-users with both fixed and mobile telephone subscriptions. Furthermore, in its response to Question 6 of the Commission's RFI, FICORA stated that the *'share of residential customers using mobile only (in 2012) is specified in figure 4 and the share of non-residential customers using mobile only (in 2010) is specified in figure 6 in the market analysis. As the data for residential and non-residential customers are based on separate surveys, a combined figure representing the global share is not available.'* BEREC suggests that this further highlights the shortcomings in FICORA's analysis. Given that a large proportion of business users still have both fixed and mobile services, insufficient evidence has been presented to demonstrate that business consumers would substitute away from a network that raised wholesale call termination charges (i.e. their network provider) and that this substitution would exercise a sufficient constraint on FTRs, thus making a FTR rise unprofitable.

The divergent figures of 13% and 54% clearly highlight differentiation between the residential and non-residential segments and, therefore, the potential for them to react differently in response to any sensitivity to the pass-through of wholesale FTR increases into retail prices.

Overall, it is BEREC's opinion that the evidence as presented by FICORA is insufficient to come to such a conclusion, just as the evidence presented by FICORA in its market analysis does not sufficiently justify its conclusion of lifting the SMP status of all fixed network operators.

Another issue raised by the Commission was that FICORA has not demonstrated that a rise in FTRs would be unprofitable for fixed operators. FICORA's arguments were based on the theory of price elasticity of demand which measures the responsiveness of consumers to price changes and the assumption that due to the existence of fixed to mobile substitution there is a competitive constraint for the fixed operators at the retail level, i.e. an increase in FTRs would lead to an increase of the retail fixed calls prices resulting in end users switching to mobile networks. While it accepted that some fixed to mobile substitution may occur, BEREC agrees with the Commission's view that a more thorough investigation is required of this relationship, taking into account that insufficient evidence was provided to prove to what extent fixed subscribers would effectively switch to mobile subscriptions because of the increase in FTRs, or call mobile numbers instead of calling fixed numbers. BEREC shares the Commission observation that the 54% figure of non-residential users who have both mobile and fixed subscriptions could be an indication that these services are complementary rather than substitutable services at least for some non-residential customers. In addition as noted by FICORA with respect to non-residential customers there are other reasons than price to keep fixed telephone services. FICORA expects that the price elasticity of demand of Fixed to Fixed and Mobile to Fixed calls to be relatively high but it has not presented any supportive and quantifiable evidence to justify it. For some customers, especially the non-residential users, the price elasticity of demand for fixed services might be inelastic and thus would be profitable for fixed operators to increase FTRs even if the increase is passed to retail prices.

Another argument by FICORA in relation to why it would be unprofitable for fixed operators to raise FTRs, has been the potential for a reciprocal increase of wholesale call termination charges as a response to the increase of the wholesale call termination from other operators both fixed and mobile. For the mobile operators, because termination rates are regulated, the increase will pass to the retail prices and this will intensify the substitution of the fixed subscriptions with mobile ones. This issue as explained in the other sections of this opinion was not fully substantiated by FICORA. As the reciprocal is a concern among fixed operators, FICORA has not presented an in depth analysis that takes into account operators' market shares, geographic coverage, traffic direction and other matters affecting operators ability to raise termination rates without reducing their wholesale revenues.

Taking into account the above, BEREC is of the opinion that FICORA did not sufficiently demonstrate that an increase in the FTR would be automatically and fully passed on to the retail prices of the calling party. This was one of the main arguments why FICORA finds that fixed operators are not able to raise the FTRs without incurring significant loss in their revenue. A certain amount of terminated minutes would be lost due to the decision of the calling party to substitute calls to a fixed number with calls to a mobile number, because of the increase of the retail prices for the party calling the network which raised FTRs.

Creation of barriers to the internal market

The Commission concluded that in the absence of a proper SMP assessment, i.e. based on a thorough analysis of the competitive conditions, the proposed deregulation of the fixed voice call termination market was not justified and might create barriers to the internal market since lifting regulation i) might lead to excessive pricing, which in turn might increase the costs for the provision of fixed services and lower the ability of other operators and service providers to provide electronic communications services in Finland; and ii) could lead to asymmetry of termination rates within Finland and compared to other Member States. According to the Commission *'any considerable asymmetry in fixed termination rates within the EU not only distorts and restricts competition but have a significant detrimental effect on the development of the internal market, i.e. creates a considerable barrier to the single market.'*

FICORA provided information showing that the share of international calls (including calls originating in the EU, and also in all the other countries) as a percentage of the total call minutes terminated to the fixed networks is minor. According to FICORA, it is hard to see that any of the international operators in the EU would face any major barriers due to the fixed call termination rates that are applied in Finland.

BEREC shares the Commission's general concern regarding the creation of barriers to the internal market when the deregulation of the fixed voice call termination market is based on an SMP assessment missing sufficient evidence to clearly demonstrate that operators with a 100% market share would not have SMP on the market for call termination on individual telephone networks provided at a fixed location.

5. CONCLUSIONS

On the basis of the analysis set out in section 4 above, BEREC considers that the Commission's serious doubts regarding the draft decision of the Finnish national regulatory authority, FICORA, concerning the review of the wholesale markets for call termination on individual public telephone networks provided at a fixed location in Finland, as expressed in the EC's letter to FICORA of 2 October 2013 (Case FI/2013/1498), are justified.

According to point 78 of Commission SMP Guidelines: *'the existence of a dominant position cannot be established on the sole basis of large market shares. As mentioned above, the existence of high market shares simply means that the operator concerned might be in a dominant position. Therefore, NRAs should undertake a thorough and overall analysis of the economic characteristics of the relevant market before coming to a conclusion as to the existence of significant market power […]'*.

Point 73 of the SMP Guidelines also points out that*: ' … in an ex-ante environment, market power is essentially measured by reference of the power of the undertaking concerned to raise prices by restricting output without incurring a significant loss of sales or revenues.'*

BEREC is of the opinion that the EC's serious doubts are justified in that FICORA has not provided, as required by point 78 of the SMP Guidelines, **a thorough and overall analysis of the economic characteristics of the relevant market** in order to conclude that, despite a 100% market share, operators in Finland would not have SMP on the market for call termination on individual public telephone networks provided at a fixed location.

In its Opinion on Case IT/2013/1415, BEREC pointed out that, pursuant to Article 19 (2) of the Framework Directive, NRAs should take utmost account of the Commission´s recommendations but can choose not to follow a recommendation. Thus the assessment and compatibility with EU law cannot be based only on non-compliance with the Termination Rates Recommendation. However, where a NRA chooses not to follow a recommendation, it has to inform the Commission and give the reasons for its position.

BEREC shares the Commission's concerns that FICORA's proposal to lift regulation from the fixed voice call termination markets in Finland, where there are doubts that FICORA has provided sufficient evidence to prove that operators would not have SMP, might lead to excessive pricing which in turn may increase the costs for the provision of fixed services and lower the ability of other operators and service providers (including those established in other Member States) to provide electronic communication services in Finland. It could also create an asymmetry of termination rates within Finland and compared to other Member States, thus could create a barrier to the internal market, if other NRAs set FTRs based on the methodology recommended by the Commission and FICORA deviates from that methodology, without valid justification.

BEREC shares the Commission's general concern regarding the creation of barriers to the internal market when the deregulation of the fixed voice call termination market is based on an SMP assessment missing convincing evidence proving that operators with a 100% market share would not have SMP on the market for call termination on individual telephone networks provided at a fixed location.