Body of European Regulators for Electronic Communications

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BEREC Opinion on

Phase II investigation

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

Case IT/2013/1415

Call termination on individual public telephone networks provided at a fixed location (market 3) in Italy

20 March 2013

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1. EXECUTIVE SUMMARY

On 7 January 2013, the Commission registered a notification by the Italian Regulatory Authority, *Autorità per le Garanzie nelle Comunicazioni* (AGCOM), concerning the price control remedies imposed on the wholesale market for call termination on individual public telephone networks provided at a fixed location to a period up to 2015 (corresponding to market 3 in Commission Recommendation 2007/879/EC of 17 December 2007)[1].

In the draft measure, AGCOM proposes a glide path until 1 January 2015 for wholesale call termination rates. As a result, fixed termination rates (FTR) based on a pure BU-LRIC model will apply in Italy only as of that date. For the years 2012, 2013 and 2014, AGCOM proposes to apply a weighted average FTR which would result from a termination rate set for 2012 (in TDM network, including also common costs) and a pure BU-LRIC based termination rate in the IP network.

On 7 February 2013, the Commission sent a serious doubts letter opening a phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC. The Commission's doubts concern the compatibility with EU law of AGCOM's draft decision concerning price control remedies for call termination on individual public telephone networks provided at a fixed location (due to the non-imposition of appropriate termination rates). 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.

On the basis of the analysis set out in this Opinion, BEREC considers that the Commission's serious doubts are justified in that: i) AGCOM's proposed FTRs are not based on a pure BU-LRIC model, as recommended by the EC, until 2015; and ii) AGCOM has not provided a valid justification for deviating from the EC recommendation and, in particular, has not provided evidence which supports its view that applying pure BU-LRIC tariffs from 2013 would have a disproportionate effect on Italian operators. AGCOM therefore did not prove that national circumstances justify the deviation from the recommended EC methodology on FTR. However, BEREC considers that AGCOM might have legitimate reasons to set a glide path (because of constraints on migration to IP-interconnection which impact the use of this technology during the migration period), with the transition FTRs being based on the costs of both TDM and IP networks.

[1] At the same time AGCOM also notified price related remedies on the call origination (corresponding to market 2 Commission Recommendation 2007/879/EC of 17 December 2007) and call transit (corresponding to market 10 in previous Commission Recommendation 2003/311/EC of 11 February 2003) on individual public telephone networks provided at a fixed location. As the serious doubts do not concern these markets they are left outside this opinion.

In addition, BEREC shares the Commission's concerns that AGCOM proposal could create barriers to the internal market if other NRAs set FTR based on the methodology recommended by the Commission and AGCOM deviates from that methodology without valid justification. On the basis of AGCOM's proposed glide path and impact estimates, BEREC considers that any such barriers are unlikely to be "considerable" and could be limited to the year 2013 only.

BEREC suggests, to the extent AGCOM finds it appropriate to set a glide path for the reasons mentioned above, that AGCOM maintains its proposed glide path but sets the transition FTRs (for 2013 and 2014) on the basis of a pure LRIC for both TDM and IP (for the avoidance of doubt, this means setting the 2013 and 2014 FTRs using AGCOM's proposed methodology in which the 2012 TDM FTR are replaced by the 2012 pure LRIC TDM FTR).

2. INTRODUCTION

On 7 January 2013, the Commission registered a notification by the Italian Regulatory Authority, AGCOM, concerning price control remedies for call origination, call termination (markets 2 and 3 respectively of current Commission Recommendation review 2007/879/EC) and call transit (market 10 of previous Commission Recommendation review 2003/311/EC) on individual telephone networks provided at a fixed location for a period up to 2015. On 17 January 2013, a request for information (RFI) was sent to AGCOM, and a response was received on 22 January 2013.

The Commission initiated a phase II investigation, pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC, with a serious doubts letter on 7 February 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 14 and 15 February 2013 the EWG sent a first list of questions to AGCOM. Answers were received from AGCOM on 15 February 2013. As a result of the meeting held in Barcelona (see below) a second list of questions was sent to AGCOM on 21 February 2013 and the answers were received on 25 February 2013.

The EWG met on 19 February 2013 in Barcelona. During this meeting, the EWG held a session with AGCOM to gather further information and clarification in response to the questions sent the week before and to additional questions. The objective of the EWG was to decide whether, based on the information available thus far, it could reach clear conclusions on whether or not the Commission's serious doubts are justified. The EWG reached preliminary conclusions on some issues but concluded that more information was required on others.

A draft opinion was finalized on 13 March 2013 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 20 March 2013. This opinion is now issued by BEREC in accordance with Article 7a(3) of the Framework Directive.

3. BACKGROUND

Previous notifications

In March 2011 AGCOM notified remedies relating to the wholesale markets for (i) call origination, (ii) call termination and (iii) transit services, all of them on public telephone networks provided at a fixed location, whose second review had been previously notified and assessed by the Commission in December 2009. AGCOM proposed rates for call origination, termination and transit services on Telecom Italia's network for 2011. Commission reiterated its comments during second market review notification, asking AGCOM to set fixed call termination rates which reflects the cost of an efficient operator and urged AGCOM to set the tariffs of all fixed network operators in a symmetric way at the level of an efficient operator at the earliest possible time.

Under case IT/2013/1413, that was also notified on 7 January 2013 as draft measure object of Commission's serious doubts, AGCOM proposed to retroactively set alternative operators' call termination rates for 2012. In its comments, Commission invited AGCOM to consider whether setting new prices with retroactive effect might lead to legal uncertainty for market players.

Current notification

In the current notification and referring to AGCOM proposes fixed termination rates (FTR) for IP-interconnection.[2] AGCOM proposes to apply a weighted average rate for the years 2013 and 2014 which are based on the rate for wholesale call termination on a TDM network set for 2012 (which includes common costs) and the rate for wholesale call termination on an IP network (set on the basis of a pure BU-LRIC cost model).

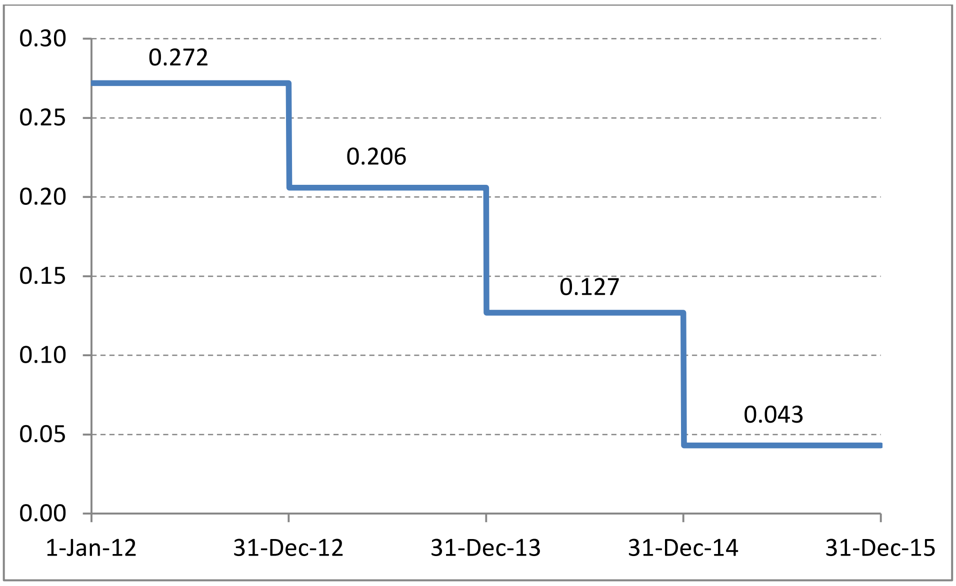
The BU-LRIC cost model uses the following assumptions:

- the modelled network is an NGN;
- the modelled operator has a 25% market share;
- the network envisages 16 gateway areas for traffic collection;
- the WACC is equal to 9.36%;
- the depreciation method is tilted annuity.

The TDM rate is 0.272, and the pure BU-LRIC rate is 0.043. Both rates are weighted in line with AGCOM's forecast of IP interconnection traffic volumes, set at 0% in 2012, 33% in 2013, 66% in 2014 and 100% in 2015. With these assumptions, AGCOM proposes the following glide path:

[2] The current measure does not include fixed termination rates for TDM-interconnection. AGCOM has announced it will draft a measure for fixed termination rates for TDM-interconnection.

Figure 1: AGCOM's proposed glide path (eurocents/min)



AGCOM points out that with its approach, FTRs in Italy will be fully symmetric since 1st January 2012. Before that, alternative operators FTRs were set at Telecom Italia's tandem switch level (0.57 eurocents/min)[3].

Commission's serious doubts

The Commission expresses serious doubts regarding the remedies on the market for call termination on individual public telephone networks provided at a fixed location for the following principal reasons:

1. ***"Need for an appropriate price control ensuring that customers derive maximum benefits in terms of efficient cost-based termination rates***

The Commission refers to Articles 8(4) and 13(2) of the Access Directive, which require the NRAs (i) to impose remedies, which are based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of the Framework Directive and (ii) in relation to the imposition of price controls to ensure that the chosen cost recovery mechanism serves to promote efficiency and sustainable competition and maximises consumer benefits. Moreover, the Commission refers to Article 16(4) of the Framework Directive which requires NRAs to impose on SMP undertakings appropriate regulatory obligations.

In the context of the wholesale termination market at a fixed location, the Commission underlines that, given its characteristics and the associated competitive and distributional concerns, the above mentioned objectives of promoting efficiency and sustainable competition, maximising consumer benefit and contributing to the development of the internal market, would best be

[3] In its answer to the second set of BEREC's questions, AGCOM clarified that in February 2013, a Court ruling in Italy stated that symmetry between alternative operators and Telecom Italia should not be based at Telecom Italia local level but at Telecom Italia national switch level (i.e. single transit). This ruling only applies for 2012 and therefore does not appear to have implications for the 2013 and 2014 FTRs. AGCOM could however not confirm this would be the case.

achieved by a cost orientation remedy based on pure BU-LRIC methodology and symmetrical termination rates.

Moreover, the Commission observes that fixed termination rates set at an efficient level contribute to a level playing field among operators by eliminating competitive distortions between fixed and mobile networks in the provision of termination services at a fixed location, and between operators with asymmetric market shares in the provision of their on/off-net offers.

As a result of the above considerations, the Commission has adopted the Termination Rates Recommendation, which lays out a consistent approach that the NRAs should follow regarding price control obligations for fixed and mobile termination rates. The Commission recommended to NRAs to ensure that termination rates are implemented at a cost efficient, symmetric level as of 31 December 2012. Normally, a cost efficient rate is the one resulting from a pure BU-LRIC methodology. However, in exceptional circumstances, where an NRA is not in a position, particularly due to limited resources, to develop the recommended cost model, the NRA may decide to use an alternative approach. Any outcome resulting from this alternative methodology should not exceed the average of the termination rates set by NRAs implementing the recommended cost methodology.

A cost orientation remedy based on a pure BU-LRIC methodology and symmetrical termination rates best promote competition by, among other things, ensuring that all users derive maximum benefit in terms of choice, price and quality, in line with Article 8(2) of the Framework Directive. Moreover, the Commission observes that termination rates, which are based on a pure BU-LRIC model, contribute to a level playing field among operators, by eliminating competitive distortions in the termination markets. Whilst the Commission recognises a certain period of time is required for the transition to the relevant pure BU-LRIC cost model, they consider that a period of transition until 31 December 2012 was sufficiently long, both for NRAs to put in place pure BULRIC models and for operators to adapt their business plans accordingly, whilst recognising the pressing need to ensure that consumers derive maximum benefits in terms of efficient cost-based termination rates.

The notified measure does not appear to comply with the above principles and objectives set out in the regulatory framework. AGCOM proposes to delay the introduction of termination rates based on a pure BU-LRIC methodology until January 2015 without providing sufficient economic justification. Instead, until 2015, AGCOM proposes to apply a weighted average FTR which would result from a termination rate set for 2012 (in TDM network, including also common costs) and a pure BU-LRIC based termination rate in the IP network. Thus, in 2013 and 2014 pure BU-LRIC based rates will not be enforced in Italy.

The Commission does not share AGCOM's justification that this additional delay would support a timely migration to IP technology. In fact, the Commission doubts that the proposed glide-path would allow for the achievement of those objectives, as it may, unnecessarily, perpetuate competitive distortions between fixed and mobile markets and/or between operators with asymmetric market shares and traffic flows and, ultimately, unduly prolong the application of consumer tariffs, which are based on above-cost wholesale inputs.

The Commission does not share AGCOM's justification, that an earlier introduction of fully-cost oriented prices would have a disproportionate impact on Italian operators.

Whilst the Commission takes note of the considerable reductions in termination income, which could affect all fixed operators, it would like to point out that AGCOM failed to set out in sufficient detail why the potentially negative impacts on fixed operators are, indeed, so disruptive that a steeper than proposed decrease of FTRs would be disproportionate and not outweighed by the evident and significant consumer benefits resulting from lower termination rates.

The Commission therefore concludes that the proposed draft measure infringes Articles 8(4) and 13(2) of the Access Directive in conjunction with Articles 8 and 16(4) of the Framework Directive.

2. Creation of barriers to the internal market

The Commission further notes that for the period termination rates are set above the efficient level (i.e. until 1 January 2015), terminating operators in Italy will be able, on the basis of the calling party pays principle, to benefit from this rate at the expense of operators, and ultimately consumers, in those Member State from which the call originates and which do apply fully cost-oriented FTRs in line with Article 8(2) of the Framework Directive and Articles 8(4) and 13(2) of the Access Directive. Hence, the considerable difference in absolute terms derived from a glide-path with an end date beyond the 1 January 2013 results in the application of significantly above-cost termination rates for 2013 and 2014 in Italy and would, thus, be incurred at the expense of the operators, and eventually consumers, in the Member States from where the fixed/mobile calls originate.

Any such considerable asymmetries in fixed termination rates within the EU not only distort and restrict competition but have a significant detrimental effect on the development of the internal market, i.e. create a considerable barrier to the single market, and, therefore, result in a violation of the principles and objectives of Article 8(2) and (3) of the Framework Directive. A harmonised approach in setting fixed termination rates is particular important to ensure that regulators do not favour their national operators at the expense of operators in other Member States by deliberately delaying the introduction of fully cost-oriented fixed termination rates for as long as possible.

It is exactly for that reason that the Commission has adopted the Recommendation to ensure a harmonised application of the Regulatory Framework in order to contribute to the development of the internal market and further the objectives set out in Article 8 of the Framework Directive.

Moreover, the Commission observes that fixed termination rates set at an efficient level contribute to a level playing field not only at national but also at EU level, by eliminating competitive distortions between fixed and mobile networks.

In light of the above considerations, the Commission considers, at this stage, that the draft measure would create barriers to the internal market."

4. ASSESSMENT OF THE SERIOUS DOUBTS

On 7 February 2013, the Commission sent a serious doubts letter opening a phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC.

BEREC assesses the serious doubts in two parts, following the concerns raised by the Commission. First, BEREC analyses the remarks of the Commission regarding the need for an appropriate price control ensuring that customers derive maximum benefits in terms of efficient cost-based termination rates. Second, BEREC examines if AGCOM proposal would create barriers to the internal market.

Need for an appropriate price control ensuring that customers derive maximum benefits in terms of efficient cost-based termination rates

Concerns of the Commission

NRAs should ensure that FTRs are implemented at a cost efficient, symmetric level as of 31 December 2012. These rates should result from a 'pure BU-LRIC' methodology. AGCOM's proposed FTRs do not appear to comply with the Termination Rates Recommendation as AGCOM proposes to delay the introduction of termination rates based on a pure BU-LRIC until 2015 without providing sufficient economic justification.

The Commission does not share AGCOM's justification that an earlier introduction of pure BU-LRIC based FTRs would have a disproportionate impact on Italian operators and outweigh the significant consumer benefits resulting from lower termination rates. The Commission also does not share AGCOM's justification that a delay until 2015 would support a timely migration to IP technology.

According to the Commission, the proposed glide path might distort competition between fixed and mobile markets and /or between operators with asymmetric market shares and traffic flows.

Views of AGCOM

AGCOM argued that an earlier introduction of pure BU-LRIC FTRs would have a disproportionate impact on Italian operators.

AGCOM has provided information to BEREC in relation to the alleged impact on the net termination revenues (i.e. termination revenues minus termination payments) of Italian fixed operators. This is presented in Table 1 below:

[REDACTED]

AGCOM also argued that at the end of 2012 only a very small proportion of traffic was exchanged through IP interconnection and TDM was still by large the most prevalent mode of interconnection. Furthermore, AGCOM estimated that at least two years are necessary for the migration process to IP interconnection to be completed, **[REDACTED]**. AGCOM considered it was therefore appropriate to set a glide path with starting prices for IP equal to the price previously set for TDM and with cost efficient, pure BU-LRIC tariffs imposed to the notified operators only from 1 January 2015. It considered appropriate, for the intermediate years (2013-2014), to weight the TDM tariffs with those determined for the IP model to take into account what it considered to be the important (albeit decreasing) role that TDM networks would continue to have during the migration phase. Such gradual path would, in AGCOM's view, stimulate operators to migrate to the new efficient technology, ensure the sustainability of the evolution towards IP interconnection without threatening operator's investments in NGN networks **[REDACTED]**.

The AGCOM proposal which was notified to the Commission did not provide any analysis or evidence of the retail competitive distortions that its proposals could have or, more generally, in relation to the impact of its proposal and/or alternative options on retail competition and/or consumers. In response to a BEREC request for information, AGCOM provided information on the (maximal) potential impact on consumers. AGCOM said that it would be difficult to provide empirical evidence on the dynamic consumer benefits resulting from lower fixed termination rates but argued that FTR reductions may not have necessarily an immediate impact on retail prices. AGCOM said it fears that customers may in the end be harmed by a huge reduction in fixed termination prices as fixed operators, in order to keep profits unchanged, may raise prices of retail unregulated services.

BEREC's Assessment

In BEREC's view, AGCOM's justification of its proposals can be grouped into two broad categories:

- The impact on fixed operators' net termination revenues;
- Issues around migration to IP interconnection.

We assess both of these below.

Impact on the net termination revenues of Italian fixed operators

AGCOM has, on BEREC's request, provided estimates of the impact of both its proposals and the (hypothetical) earlier adoption of pure BU-LRIC FTRs based on a full IP network on the net fixed termination revenues of Italian fixed operators.

Table 1 above shows a negative net cumulative impact of implementing a pure BU-LRIC as of 2013 on fixed operators of **[REDACTED]** over the period 2013-2015 (or **[REDACTED]** per year). The table also shows that, when compared to AGCOM's current proposals, this impact is **[REDACTED]** over the period 2013-2015 (or **[REDACTED]** per year).

The largest impact of implementing a pure BU-LRIC as of 2013 on a single operator is on Telecom Italia, with a net negative impact of **[REDACTED]** over the period 2013-2015 (or **[REDACTED]** per year). The impact on other fixed operators is largely positive, at **[REDACTED]** over the period 2013-2015 (or **[REDACTED]** per year) with only one operator incurring a negative net impact of **[REDACTED]** over the period 2013-2015 (or **[REDACTED]** per year).

AGCOM clarified to BEREC that their use of the term "disproportionate impact on Italian operators" of implementing pure BU-LRIC FTRs as early as in 2013 relates to the impact on other operators (i.e. other than Telecom Italia), mainly as a result of Telecom Italia's schedule of migrating those operators to IP technology (which we discuss below). BEREC does not consider that the data provided by AGCOM (namely the **[REDACTED]** positive impact for other operators over the period 2013-2015) supports its concerns in relation to the impact on other operators; in fact, they largely appear to contradict AGCOM's claims on this issue.

Furthermore, BEREC understands that the estimated impacts are the 'direct' impacts, assuming 'everything else remains the same', i.e. they do not take into account any reaction from Italian operators to the proposed changes in fixed termination rates (especially from Telecom Italia which would incur the largest negative impact). In particular, they do not take into account the following potential reactions:

- Commercial reactions such as changes in retail prices and/or other wholesale prices: in the absence of regulatory or contractual barriers, fixed operators who would no longer be able to recover common costs through pure BU-LRIC FTR could seek to recover these costs through their retail and/or other wholesale services;

- The potential cost savings arising as the result of operators migrating sooner than expected to new, cost-efficient technology in reaction to the proposals (in particular as the result of an earlier introduction of pure BU-LRIC FTR).

Specifically, to the extent that Italian operators would reflect the impact of changes in FTR on retail fixed voice consumers, AGCOM did not provide any analysis in its notification to the Commission on the likelihood and extent of this happening. On BEREC's request, AGCOM has provided estimates of the potential impact on consumers, assuming they would bear the full impact and how it compares with average industry revenues from retail fixed voice services.

Whether, and to what extent, the impact on Italian fixed operators (of implementing a full BU-LRIC FTR based on a full IP network as early as in 2013) would be passed onto retail fixed voice consumers would, in BEREC's opinion, depend on a number of factors related to the competitive conditions in the Italian fixed voice retail markets. BEREC notes that there is a significant asymmetry between the estimated direct impacts on Telecom Italia (which is significantly negative) and that on other fixed operators (mostly positive individually, significantly overall). This means that the incentives to reflect these impacts at the retail level are likely to vary between these operators and the direction (e.g. price increase/decrease) and extent to which this would occur depends on the competitive conditions in the retail markets.

To the extent that fixed operators would fully pass the impact of an earlier implementation in 2013 of pure BU-LRIC FTRs onto their retail consumers in the fixed voice market (i.e., assuming a 100% 'waterbed' effect[4]), AGCOM estimates that this would result in a net negative impact per fixed line subscriber of around **[REDACTED]** per year (or **[REDACTED]** per year when compared to AGCOM's current proposal) for the period 2013-2015. To put this impact into perspective, it would correspond to **[REDACTED]** of the annual average revenue per user on fixed retail voice services (**[REDACTED]** when compared to AGCOM's current proposal).

Because these estimates assume a full pass-through, they constitute an upper bound of any potential negative impact on fixed line consumers. BEREC does not consider such impact on consumers to be "disproportionate". Furthermore, as discussed above, the true impact on consumers could be significantly less, depending on the competitive conditions in the Italian retail fixed voice markets (that is, BEREC considers that the waterbed effect is unlikely to be complete).

The impacts estimated above do not take into account the dynamic competition benefits from implementing pure BU-LRIC termination rates in 2013. AGCOM said it would be difficult to provide empirical evidence on the dynamic consumer benefits resulting from lower fixed termination, which BEREC accepts is a non trivial exercise.

[4] The 'waterbed effect' refers to the situation where a change in one set of prices leads to changes in prices in a different part of the market

Regarding the impact of a hypothetical implementation of BU-LRIC termination rates as of 2013 on other wholesale services, AGCOM has confirmed to BEREC that there are no specific regulatory constraints from AGCOM which would imply that fixed operators cannot seek to recover from other wholesale services some of the common costs they would no longer be able to recover through FTRs; **[REDACTED]**.

In relation to the latter point, BEREC considers that the implementation of pure BU-LRIC FTR might raise some issues in relation to the recovery of those common costs that can no longer be recovered through FTR and potentially create competitive distortions at the retail level between direct access operators and WLR/CPS operators.. A number of NRAs in Europe have proposed (or are proposing) various measures to allow for the recovery of common costs that would no longer be recovered from FTRs, from other regulated wholesale services.[5] BEREC is also currently working towards the production of an internal guidance on this issue.

Migration to IP networks

BEREC considers there to be two issues:

- Issue 1– Whether migration issues justify a glide path with FTRs during the transition period being based on both TDM and IP network; and

- Issue 2– The choice of the cost standard for setting FTRs.

In relation to the first issue, AGCOM argues that the glide path is justified because Telecom Italia requires about **[REDACTED]** months to migrate each operator and cannot migrate operators simultaneously. AGCOM ruled that all migrations would need to be completed within two years, with the decision on the schedule and speed of migration being left to Telecom Italia. AGCOM argues that, without the glide path, those operators that Telecom Italia would schedule to migrate last would be discriminated against (AGCOM clarified to BEREC this is what it meant by disproportionate impact on operators) as they would continue to incur TDM costs but charge termination rates based on IP technology if these were implemented as of 2013.

BEREC considers that, in itself, a glide path might be appropriate. AGCOM provided evidence that it will take at least two years to complete the migration towards IP interconnection and that operators have little control on this process, particularly in relation to the schedule of migration established by Telecom Italia. BEREC considers that this might constitute a legitimate reason to consider a glide path with FTRs being based both on TDM and IP technology during the transition period in order to reflect the technology that will prevail during the migration period and provide incentives to migrate to IP-interconnection. In particular, it reflects AGCOM's view that, while TDM might be the available technology in 2012, it expects the efficient available technology to be fully IP in 2015. This approach of taking into account migration issues when setting FTRs also appears to have been accepted by the Commission in previous 'market 3' notifications by other NRAs.[6] BEREC notes however that the incentives to migrate would not apply to other operators as Telecom Italia is the operator determining the schedule and speed of migration for them.

[5] Countries that have applied (or are proposing) a mark-up on wholesale outgoing traffic tariffs include the UK, Norway, Czech Republic and Malta. Countries that have applied (or are proposing) a mark-up on the monthly rental fee of access (e.g. Wholesale Line Rental) include France and Denmark.
[6] See for example case IE/2012/1371, where COMREG set BU-LRIC FTR tariffs for 2013 based on TDM technology, for 2014 based on hybrid TDM/NGN technology and 2015 and forward based on NGN. The Commission had no comments on this approach used by COMREG.

In relation to the second issue, BEREC considers that AGCOM did not provide any justification or evidence as to why, to the extent that it considers it appropriate for the reasons discussed above to set a glide path with FTRs being based on both TDM and IP technologies, it did not choose to do so on the basis of pure LRIC for both technologies and, accordingly, set transition FTR (in 2013 and 2014) for IP termination on the basis of the 2012 pure LRIC TDM prices (i.e. excluding any allocation for common cost recovery). AGCOM submitted to BEREC that the reason why it did not chose a TDM BU LRIC model for the determination of the TDM tariff in the years 2013 and 2014 was that during the migration process all operators have to keep simultaneously two active networks, therefore temporarily bearing higher costs compared to those under a single existing technology. In other words, in AGCOM's view, TDM technology costs cannot be considered avoidable during the migration phase as all the operators keep their TDM network in place until the process is completed.

BEREC considers that the above argument is relevant only to the issue of whether the transition FTRs should reflect both technologies, but not to the issue of what cost standard should be applied and AGCOM has not provided a valid justification (in terms of the impact on consumers and competition) of why it deviated from the EC recommendation on this issue. AGCOM said it did not develop a pure BU LRIC TDM model but, assuming a similar treatment of common costs across its IP and TDM models, estimates that pure LRIC TDM tariffs would be roughly between **[REDACTED]** cent per minute. As discussed above, BEREC does not consider that implementing full BU-LRIC termination rates as of 2013 would, overall, have a disproportionate impact on Italian operators or on consumers (on a static basis if they ultimately bear the full impact). The impact on other operators would be largely positive overall. A modified version of the AGCOM proposals in which FTRs do not include any allocation for common costs would likely have a much lower impact on Italian operators or consumers (on a static basis) and address AGCOM's concerns in relation to constraints on migration. Furthermore, compared to AGCOM's current proposals, the impact of this modified approach on operators is unlikely to be significant as only the rates for 2013 would be materially affected (**[REDACTED]**). AGCOM did not therefore prove that national circumstances justify the deviation from the recommended FTR methodology.

BEREC therefore considers that, to the extent it is appropriate for AGCOM to set a glide path with the transition FTRs for 2013 and 2014 being based of both TDM and IP technologies, AGCOM has not provided a valid justification as to why it did not set these rates on the basis of a pure LRIC for TDM.

In its serious doubts letter, the Commission stated that any outcome resulting from an alternative methodology to a pure BU-LRIC should not exceed the average of the termination rates set by NRAs implementing the recommended cost methodology. As BEREC said in its opinion on the EC Phase II case against the Czech NRA[7], the Commission concerns should not be justified by the level of FTRs *per se* but, rather, by whether they are based on the

[7] BEREC Opinion on Phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC: Case CZ/2012/1392 "Call termination on individual public telephone networks provided at a fixed location (market 3) in the Czech Republic", http://berec.europa.eu/eng/document_register/subject_matter/berec/opinions/1157-berec-opinion-on-phase-ii-investigation-pursuant-to-article-7a-of-directive-200221ec-as-amended-by-directive-2009140ec-case-cz20121392-call-termination-on-individual-public-telephone-networks-provided-at-a-fixed-location-market-3-in-the-czech-republic

Commission’s recommended methodology. According to BEREC, if AGCOM set the transition FTRs (for 2013 and 2014) on the basis of a pure LRIC for both TDM and IP this would be in line with recommended cost methodology, taking into account the evidence provided by AGCOM in relation to migration constraints.

Competitive distortions

BEREC is not in a position to conduct a thorough analysis on the potential competitive distortions implied by AGCOM’s measure. However, BEREC notes that, in general, the current levels of FTRs relative to mobile termination rates (MTR) implies that AGCOM’s proposals are unlikely to create the same competitive distortions between fixed and mobile operators as those that might have arisen under the higher differential in MTR/FTR that prevailed prior to the EC recommendation to set MTRs at pure LRIC.

On BERECs request, AGCOM has provided some information in relation to retail markets, which is summarised below:

- All operators offer flat tariffs including an unlimited number of calls to local and national numbers;
- Mobile retail offers (and the structure of tariff plans) appear to be affected by the level of competition in the mobile retail markets and mobile termination rates. In particular, fixed termination rates do not appear to have a strong effect on the retail offers of mobile operators who, further, do not differentiate their prices between mobile-to-mobile calls and mobile-to-fixed calls.

BEREC considers that the prevalence of flat rates for retail fixed calls, the lack of a price differential between mobile-to-mobile calls and mobile-to-fixed calls, the increasing general trend in bundling of fixed telecom services, combined with the current levels of FTRs imply that it is unclear whether AGCOM’s proposals would create significant distortions in the retail markets.

Creation of barriers to the internal market

Concerns of the Commission

The Commission said that during the period until 2015, terminating operators in Italy would benefit from higher FTRs at the expense of originating operators, and ultimately consumers, in those member states that apply fully cost oriented pure BU-LRIC FTRs. According to the Commission, *“any considerable asymmetries in fixed termination rates within the EU not only distort and restrict competition but have a significant detrimental effect on the development of the internal market, i.e. create a considerable barrier to the single market.”*

Views of AGCOM

AGCOM did not provide any evidence against the previous EC statement in its proposed measure. In the response to question 7 of the Commission RFI, AGCOM argued that *“although the intermediate values of the glide path (for 2013 and 2014) are actually higher than the average among the values of the States where a pure BU-LRIC methodology is used, the final value of the proposed glide path (relating to 2015) is significantly lower than* *those approved by other NRAs (for instance, it is around half of the value approved in France and about 60% of that approved by ComReg for the half of 2015, which is 0,072 €cent/min).”*

BEREC’s Assessment

BEREC shares the Commission’s general concern regarding the creation of barriers to the internal market through the setting of widely different termination rates across EU members. We note that this was one of the main reasons for issuing a Recommendation on termination rates.

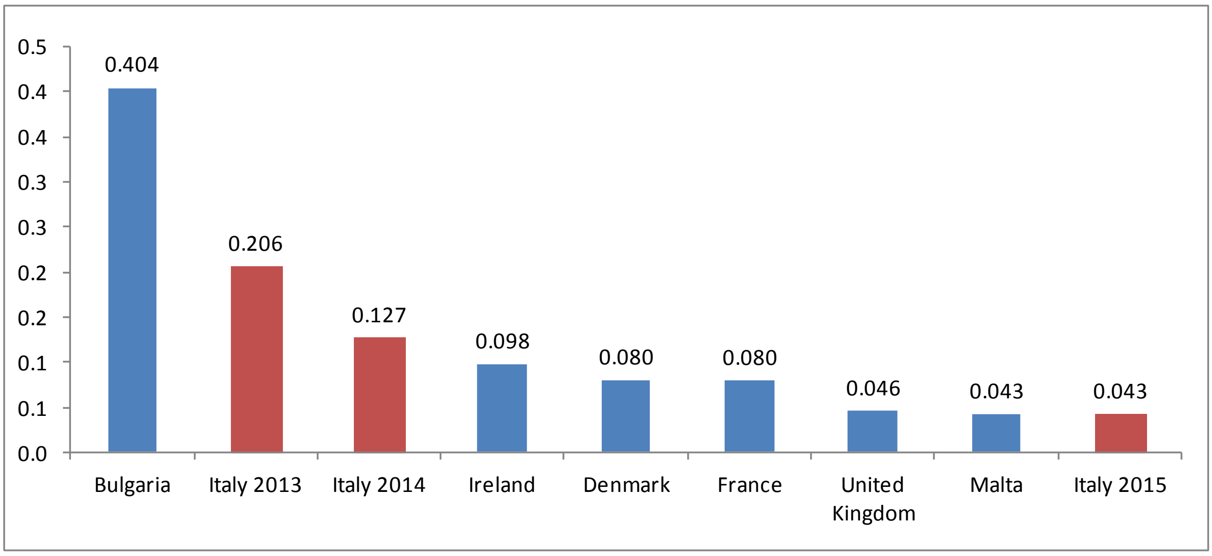
In BEREC’s view, however, concerns in relation to the creation of internal barriers should not be based on the level (or difference in absolute levels) of FTRs. As BEREC said in its opinion on the EC Phase II case against the Czech NRA[8], the Commission concerns should not be justified by the level of FTRs *when* they are based on the Commission’s recommended methodology. Therefore, BEREC shares the concerns of the Commission only to the extent that different FTRs across Member States are the outcome of different methodologies, particularly where the methodologies depart from the FTR recommendation without a valid justification.

But even in case BEREC follows the Commission in the comparison of the absolute tariff levels, and compares the absolute FTRs proposed by AGCOM with the average of pure BU-LRIC termination rates the effect on the internal market could be limited to 2013 only. Figure 2 below presents FTRs in those countries that have already determined pure BU-LRIC FTR and how they compare to AGCOM proposed prices for 2013, 2014 and 2015.

Figure 2: AGCOM’s proposed FTRs vs pure BU-LRIC (eurocents/minute)[9]

[8] BEREC Opinion on Phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC: Case CZ/2012/1392 "Call termination on individual public telephone networks provided at a fixed location (market 3) in the Czech Republic", http://berec.europa.eu/eng/document_register/subject_matter/berec/opinions/1157-berec-opinion-on-phase-ii-investigation-pursuant-to-article-7a-of-directive-200221ec-as-amended-by-directive-2009140ec-case-cz20121392-call-termination-on-individual-public-telephone-networks-provided-at-a-fixed-location-market-3-in-the-czech-republic

[9] For countries with peak/off-peak price differentiation, the average price was estimated asumming a 60/40 traffic distribution. For Denmark, that has a set-up fee, the average price was calculatedusing 2 minutes as the average length of the calls.



The proposed FTR for 2013 in Italy is about twice as high as the average pure BU-LRIC tariffs from other countries[10]. However, the Italian 2014 FTR is roughly in line with that average. Finally, AGCOM's proposed pure BU-LRIC FTR for 2015 is at the lower end of the available comparators. This implies that, any potential barrier to the internal market created by AGCOM's proposals would be limited to 2013.

BEREC has asked AGCOM to provide estimates of the impact on cross border net revenues between Italy and EU member states of their proposal versus a proposal fully based on BU-LRIC rates already in 2013. According to AGCOM, the impact for 2013[11] would be less than **[REDACTED]**. While BEREC shares the Commission's concerns that AGCOM proposal could create barriers to the internal market, it considers that, on the basis of AGCOM's estimates, any such barriers are unlikely to be "considerable" and would be limited to the year 2013. Therefore, BEREC considers that the Commission has not made it clear why AGCOM's proposals would *"have a significant detrimental effect on the development of the internal market, i.e. create a considerable barrier to the single market"*.

5. CONCLUSIONS

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.

On the basis of the analysis set out in section 4 above, BEREC considers that the Commission's serious doubts are justified in that i) AGCOM's proposed FTRs are not based on a pure BU-LRIC model, as recommended by the EC, until 2015 and ii) AGCOM has not provided a valid justification for deviating from the EC recommendation and in particular , has not provided evidence with supports its view that applying pure BU-LRIC tariffs from 2013

[10] Including Bulgaria and Italy tariffs, the average pure BU-LRIC FTR is 0.1135 eurocents/minute.
[11] **[REDACTED]**

would have a disproportionate effect on Italian operators. AGCOM therefore did not prove that national circumstances justify the deviation from the recommended FTR methodology. However, BEREC considers that AGCOM might have legitimate reasons to set a glide path (because of constraints on migration to IP-interconnection which impact the use of this technology during the migration period) with the transition FTRs being based on the costs of both TDM and IP networks.

In addition, BEREC shares the Commission's concerns that AGCOM proposal could create barriers to the internal market if other NRAs set FTR based on the methodology recommended by the Commission and AGCOM deviates from that methodology without valid justification. On the basis of AGCOM's proposed glide path and impact estimates, BEREC considers that any such barriers are unlikely to be "considerable" and could be limited to the year 2013 only.

BEREC suggests, to the extent AGCOM finds it appropriate to set a glide path for reasons mentioned above, that AGCOM maintains its proposed glide path but sets the transition FTRs (for 2013 and 2014) on the basis of a pure LRIC for both TDM and IP (for the avoidance of doubt, this means setting the 2013 and 2014 FTRs using AGCOM's proposed methodology in which the 2012 TDM FTR are replaced by the 2012 pure LRIC TDM FTR).