Body of European Regulators for Electronic Communications

BEREC

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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 DE/2013/1424

Wholesale voice call termination on individual mobile networks (market 7) in Germany

10 April 2013

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1. EXECUTIVE SUMMARY

On 31 January 2013, the Commission registered a notification from the German national regulatory authority, the Bundesnetzagentur (BNetzA), concerning the markets for wholesale voice call termination on individual mobile networks in Germany (corresponding to market 7 in Commission Recommendation 2007/879/EC of 17 December 2007).

In the present notified draft measures, which concerns the imposition of remedies on the designated SMP[1] operators, BNetzA especially proposes to set the following symmetric mobile termination rates (MTRs) for all SMP operators, by employing a LRIC+ costing methodology :

- For the period of 1 December 2012 to 30 November 2013: 1.85 €ct/min
- For the period of 1 December 2013 to 30 November 2014: 1.79 €ct/min

On 28 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 relate to the compatibility with EU law of BNetzA's draft decision concerning price control remedies for wholesale call termination on individual mobile networks, due to the methodology used to calculate the costs of an efficient operator.

In particular, the Commission expressed serious doubts as to the compatibility of the draft measures with the requirements of Article 8(4) and 13(2) of the Access Directive in conjunction with Article 8 and Article 16(4) of the Framework Directive. The Commission also considered that the measures contained in the draft decision may create barriers to the internal market.

On the basis of the analysis set out in this Opinion, BEREC considers that the Commission's serious doubts are justified in that BNetzA's proposed MTRs from December 2012 until November 2014 are not based on a pure LRIC costing methodology. However, BEREC considers that under Article 19 of the Framework Directive, a NRA can deviate from a recommendation, here the Recommendation 2009/396/EC on Termination Rates, in the condition that it shall inform the Commission giving the reasons for its position.

Since upon Article 13(2) of the Access Directive a NRA shall ensure that any cost recovery mechanism or pricing methodology that is mandated serves to promote efficiency and sustainable competition and maximise consumer benefits, adding to the fact that the Recommendation on Termination rates recommends (upon article 2 and 6) that the cost of efficient service provision for mobile termination rates is the pure LRIC, under the current framework, a NRA who want to deviate from it should give the reasons why another costing methodology would be better suited to meet those objectives, as well as the policy objectives referred in Article 8, that are equally weighted, of the Framework Directive. In BEREC's opinion, BNetzA has not proved that applying pure LRIC based tariffs would have a disproportionate effect on German operators, and also has not proved that LRIC+ approach would be better suited to meet the policy objectives of promoting efficiency and sustainable competition and maximize consumer benefits than the recommended pure LRIC one.

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[1] T-Mobile, Vodafone, E-Plus, O2, Lycamobile and One Phone (OnePhone is connected with E-Plus via the common mother company KPN NV but it is offering its own voice call termination services)

In addition, BEREC shares the Commission's serious doubts that BNetzA proposal could create barriers to the internal market as BNetzA's proposals are based on an alternative methodology to that recommended by the Commission and the proposed MTR for 2013 in Germany would be approximately twice as high as the average pure LRIC tariffs from other countries that have set tariffs based on pure LRIC (via a bottom-up model or by benchmarking)[2]. Moreover, BEREC considers that, since the 2014 tariffs are also based upon a LRIC+ approach, such barriers would not only be limited to the year 2013.

BEREC recommends that BNetzA set the tariffs of the mobile termination rates, of the operators designated as having SMP in the market for wholesale voice call termination on their respective individual mobile networks, on the basis of a pure LRIC costing methodology, without any glide path.

2. INTRODUCTION

Under Article 7 and 7a of the Framework Directive[3], and Article 3(1a) of the BEREC Regulation[4], one of the roles of BEREC is to deliver opinions on draft measures of national regulatory authorities (NRAs) concerning market definition, the designation of undertakings with significant market power and the imposition of remedies, and to cooperate and work together with the NRAs. Article 2(a) of the BEREC Regulation requires BEREC to develop and disseminate among NRAs regulatory best practice, such as common approaches, methodologies or guidelines on the implementation of the EU regulatory framework.

On 31 January 2013, the Commission registered a notification from the German national regulatory authority, BNetzA, concerning the markets for wholesale voice call termination on individual mobile networks in Germany (corresponding to market 7 in Commission Recommendation 2007/879/EC of 17 December 2007). On 12 February 2013, a request for information was sent to BNetzA followed by an additional request dated 13 February 2013 and responses were received on 15 February 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 28 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 8 March 2013 the EWG sent a first list of questions to BNetzA. Answers were received from BNetzA on 12 March 2013. Additional questions were sent the day of the meeting held in Paris (see below), with answers received on 15 March 2013. A final list of questions was sent to BNetzA on 19 March 2013 and the answers were received on 22 March 2013.

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[2] For example the 5 most populous Member States (leaving aside Germany itself) are all applying a pure BU-LRIC rate: FR (FR/2011/1200) with a target rate of 0.80 €ct/min; IT (IT/2011/1219), 0.98 €ct/min; ES (ES/2012/1291), 1.09 €ct/min; UK (UK/2010/1068), 0.86* €ct/min; PL (PL/2012/1368), 1.04* €ct/min (*depending on exchange rate).
[3] Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services
[4] Regulation (EC) 1211/2009 establishing the Body of European Regulators for Electronic Communications (BEREC) and the Office.

The EWG met on 13 March 2013 in Paris. During this meeting, the EWG held a session with BNetzA 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 3 April 2013 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 10 April 2013. This opinion is now issued by BEREC in accordance with Article 7a(3) of the Framework Directive.

3. BACKGROUND

Previous notifications

The third round of market analyses of the German markets for voice call termination on individual mobile networks was previously notified to and assessed by the Commission in 2011[5]. At the time BNetzA notified its proposal for market definition and the assessment of significant market power (SMP).

With regards to the market definition, BNetzA defined distinct markets for voice call termination on the networks of the mobile network operators (MNOs) Telekom Deutschland GmbH (T-Mobile), Vodafone D2 GmbH (Vodafone), E-Plus Mobilfunk GmbH & Co. KG (E-Plus) and Telefónica O2 Germany GmbH & Co. OHG (O2) as well as the full MVNOs[6], namely Vistream GmbH (Vistream)[7], Ring Mobilfunk (Ring)[8], Lycamobile Germany GmbH (Lycamobile) and OnePhone Deutschland GmbH (OnePhone)[9].

The geographic scope of each market coincides with the geographic coverage of the network concerned and is determined as national. BNetzA designated T-Mobile, Vodafone, E-Plus, O2, Vistream, Ring, Lycamobile and OnePhone as having SMP in the market for wholesale voice call termination on their respective individual (virtual) mobile networks.

[5] Case DE/2011/1274, C(2011) 10077.

[6] According to BNetzA, full MVNOs provide call termination services in their own virtual mobile network vis-à-vis third parties, and negotiate the call termination charges on their own, independent of their mobile host network operators, with the consumers of the corresponding call termination services. So called "light" MVNOs do not offer voice call termination services and are not covered by the market definitions.

[7] In response to the Commission's request for information, BNetzA confirmed that due to on-going insolvency proceedings, Vistream GmbH, which since February 2012 operated as Telogic Germany GmbH, currently does not offer mobile call termination services.

[8] Under case DE/2012/1347 BNetzA notified to the Commission the withdrawal of all obligations regarding Ring Mobilfunk as this operator ceased to provide mobile call termination services.

[9] The full MVNO OnePhone is connected with E-Plus via the common mother company KPN NV but it is offering its own voice call termination services.

Current notification

The notified draft measures concerns the imposition of remedies on the designated SMP operators. In this respect BNetzA proposes to impose the following set of remedies on T-Mobile, Vodafone, E-Plus[10], O2 and Lycamobile:

- Access obligations, including co-location;
- A non-discrimination obligation;
- Transparency obligations, including the publication of standard reference offers[11]; and
- An obligation to offer mobile call termination at cost-orientation.

Costing methodology for mobile termination rates

With regards to the obligation of cost-orientation, BNetzA, proposes to set (retrospectively) the following symmetric mobile termination rates (MTRs) for all SMP operators[12]:

- For the period of 1 December 2012 to 30 November 2013: 1.85 €ct/min.
- For the period of 1 December 2013 to 30 November 2014: 1.79 €ct/min.

As part of the current notification BNetzA sets out draft measures which describe the precise cost model to be used to calculate wholesale voice call termination charges for mobile networks. BNetzA proposes to calculate the costs of an efficient operator by employing a LRIC+ costing methodology. In doing so, BNetzA includes in its relevant cost stack both 'non-traffic-related' common costs as well as traffic-related costs, which could be attributable to services other than wholesale voice mobile call termination.

Whilst this approach leads, as recommended by the Commission, to the application of symmetric MTRs across Germany, by proposing a LRIC+ instead of a pure LRIC costing methodology BNetzA chooses not to follow a core part of the Termination Rates Recommendation[13]. BNetzA states in its draft measure that the relevant provisions of the German telecommunications law (TKG) have to be interpreted in the light of EU law in general and the Termination Rates Recommendation in particular, and that – in case of conflict – methods set out by the Commission prevail over the regulatory default model set out by national law. BNetzA, nevertheless, justifies its decision not to follow the recommended pure LRIC approach by alleging that the non-recognition of common costs falls within its wider discretion to choose the most appropriate regulatory model and by stating that a pure LRIC methodology would not be better suited to meet the policy objectives of promoting competition and the interest of citizens and consumers. Furthermore, in its notification BNetzA states that with regards to the policy objective of contributing to the

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[10] In response to the Commission's request for information, BNetzA confirmed that the measures imposed on E-Plus will also apply to OnePhone GmbH as an enterprise legally connected through the same mother company (KPN NV).

[11] It has to be noted, though, that the transparency obligation imposed on Lycamobile does not also include an obligation to publish a standard reference offer. Instead, BNetzA proposes to oblige Lycamobile to publish relevant information in relation to technical specifications, access conditions and relevant tariffs.

[12] In addition to MTRs, BNetzA also proposes to set the charges for related services, such as, for example, a one-off fee for the provision of intra-building segments at 2Mbit/s (483.20 €), an annual rental charge for intra-building segments at 2 Mbit/s (764.22 €) and an annual rental charge for common channel signaling (331.65 €). Other related services may be charged according to actual expenses.

[13] See in particular Recommends 2 and 6 and the Annex of the Commission Recommendation of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, OJ L124, p. 67 (the "Termination Rates Recommendation").

development of the internal market, the proposed approach is preferable, as a pure LRIC approach would not serve better the internal market objective, as it would not, in BNetzA's view, be better suited to achieve the other two policy objectives, thus denying the self-standing importance of the objective to contribute to the internal market.

BNetzA does not propose to introduce the target rate using a glide-path but intends to impose the MTR calculated pursuant to the proposed cost model with immediate effect. Due to expected efficiency gains BNetzA proposes to introduce a slight decrease after the first year.

Commission's serious doubts

The Commission expresses serious doubts regarding the remedies on the market for wholesale voice call termination on individual mobile networks in Germany for the following principal reasons:

The need to ensure that customers derive maximum benefits in terms of efficient cost based termination rates

Compliance with Articles 8(4) and 13(2) of the Access Directive in conjunction with Article 8 of the Framework Directive and Article 16(4) of the Framework Directive

The Commission refers to Articles 8(4) and 13(2) of the Access Directive[14], which require 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 maximizes 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.

The European Commission reminds that when adopting the Termination Rates Recommendation, the Commission clearly stated that, when deciding on the correct level of the regulated wholesale mobile termination rate, it is essential to ensure that the methodology chosen pursuant to Article 13 (2) of the Access Directive promotes efficient production and consumption decisions and minimises artificial transfers and distortions between competitors and consumers.

The Commission noted the existence of the Recommendation, which recommends that NRAs set termination rates based on a pure LRIC cost standard in order to promote competition, ensuring that all users derive maximum benefit in terms of choice, price and quality in line with Article 8(2) of the Framework Directive. The Commission recognised that NRAs can deviate from the Recommendation but that an alternative methodology should be duly justified in light of the policy objectives and regulatory principles of the Regulatory Framework. The Commission considered that the measures contained in the draft decision do not appear to comply with these principles and objectives, and that BNetzA departed from the pure LRIC costing methodology without providing sufficient and compelling economic

[14] Directive 2002/19/EC of the European parliament and the Council of 7 March 2002 on access to, and interconnection, of electronic communications networks and associated facilities, OJ L 108, 24.4.2002, p. 7 (the Access Directive).

reasons to show that the LRIC+ methodology would be better suited to promote efficiency and sustainable competition and maximise consumer benefit in the German market.

In particular, the Commission considered that the proposed LRIC+ methodology may lead to competitive distortions between fixed and mobile operators and/or between mobile operators with asymmetric market shares and traffic flows and, ultimately, lead to the application of consumer tariffs, which are based on wholesale inputs above avoidable costs.

Creation of barriers to the internal market

The Commission stresses that pursuant to Article 8(3) of the Framework Directive, NRAs shall contribute to the development of the internal market by cooperating with each other, with the Commission and BEREC in a transparent manner to ensure not only the development of a consistent regulatory practice but also consistent application of the Regulatory Framework.

The Commission further notes that due to the fact that BNetzA intends to set mobile termination rates above the level of avoidable costs, terminating operators in Germany 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 MTRs in line with Article 8(2) of the Framework Directive and Articles 8(4) and 13(2) of the Access Directive[15].

Any such considerable asymmetries in mobile 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.

Moreover, the Commission observes that mobile 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.

Leaving aside the validity of BNetzA's claim (which the Commission questions) that the proposed approach is the most appropriate to achieve the policy objectives of Article 8(2) and (4) of the Framework Directive, the Commission does not share BNetzA's assertion that the third policy objective of Article 8(3) of the Framework Directive is subordinate to the other two. In the light of this, a "competition of systems", as suggested by BNetzA, would be detrimental to furthering the internal market, as it would create exactly the type of inward-looking national assessment that Article 8(3) of the Framework Directive attempts to prevent.

Conclusion

The Commission observes that BNetzA's notification does not provide sufficient justification of why its proposed approach for the markets for voice call termination on individual mobile networks in Germany meets the policy objectives and regulatory principles enshrined in Article 8 of the Framework Directive, and can be considered to be in line with Article 8(4) of

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[15] For example the 5 most populous Member States (leaving aside Germany itself) are all applying a pure LRIC rate: FR (FR/2011/1200) with a target rate of 0.80 €ct/min; IT (IT/2011/1219), 0.98 €ct/min; ES (ES/2012/1291), 1.09 €ct/min; UK (UK/2010/1068), 0.86* €ct/min; PL (PL/2012/1368), 1.04* €ct/min (*depending on exchange rate).

the Access Directive. Hence, the Commission has serious doubts that BNetzA's proposal on mobile termination rates can be considered appropriate in the given termination markets within the meaning of Article 16(4) of the Framework Directive and justified in light of the objectives laid down in Article 8 of the Framework Directive, and in particular the objectives of promoting competition and user benefits pursuant to Article 8(2) of the Framework Directive and believes, at this stage, that the draft measure would create barriers to the internal market.

4. ASSESSMENT OF THE SERIOUS DOUBTS

On 28 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.

As a summary, BEREC notes that the legal starting point for its analysis has to be the pure LRIC approach as laid down in the Recommendation on termination rates and not the LRIC+ (designated under CESP by BNetzA, standing for Cost of Efficient Service Provision) approach followed by BNetzA. Although it is understandable that BNetzA starts the argumentation from the concept that was previously used in its termination market decisions, it is nevertheless inappropriate not to start from the Recommendation based on the Article 19 of the Framework Directive. Indeed, starting from the Recommendation would ensure that all arguments developed by the European Commission in favour of a pure LRIC approach are adequately reflected. Based on this starting point, and after analysing both methodological and competition issues to use a LRIC+ approach rather than a pure LRIC one in order to set mobile termination rates, BEREC shares the overall serious doubts of the Commission.

BEREC assesses the serious doubts in three parts. The first part deals with the legal aspect of the German telecommunication law vs the European regulatory framework. Then, BEREC assess the two main concerns of the Commission, each time taking into account BNetzA’s arguments but with looking if they justify to deviate from the Recommendation, thus from pure LRIC. First concern being *the need to ensure that customers derive maximum benefits in terms of efficient cost based termination rates*. Second concern being *the creation of barriers to the internal market*.

1. General observations

On its notified decision, BNetzA explains that, based on its national law, the non-recognition of common costs falls within its wider discretion to choose the most appropriate regulatory model. This comes from the fact that under Section 30(1) of the TKG, the Deliberation Chamber decided to subject the charges for termination services of the authorisation pursuant to the standard of Section 31 of the TKG.

Within Section 31 (1)(1) of the TKG, the BNetzA can approve rates on the basis of the CESP (or LRIC+) according to section 32[16] for the individual services, but has the derogation, within Section 31 (2)(2) to approve rates on the basis of other procedures, provided the procedures according to paras 1 or 2 are better suited than the procedures referred to in subsection (1) (especially referring to section 32) to achieve the regulatory aims according to section 2.

In BNetzA's view, based on the TKG, its role is to assess whether pure LRIC costing methodology ("other procedures") is better suited than LRIC+ (cost methodology according to Section 32) to achieve the policy objectives.

BEREC considers that under Article 19 of the Framework Directive, a NRA can deviate from a recommendation, here the Recommendation 2009/396/EC on Termination Rates, in the condition that it shall inform the Commission giving the reasons for its position.

Since upon Article 13(2) of the Access Directive a NRA shall ensure that any cost recovery mechanism or pricing methodology that is mandated serves to promote efficiency and sustainable competition and maximise consumer benefits, and since it is recommended by the Commission, within Article 2 and 6 of the above Recommendation, that the cost of efficient service provision for mobile termination rates is the pure LRIC, under the current EU framework, any NRA which wants to deviate from it has to provide sufficient and compelling economic reasons as to why another cost methodology would be better suited to meet the policy objectives.

As a consequence, in the present case, BEREC cannot endorse BNetzA's approach, i.e. deviating from pure LRIC on the basis of the justification that pure LRIC would not be better suited than LRIC+ (see section 3.6.5.1.3.1 on page 37 of the notified document[17]), but considers that a proper justification of the choice of LRIC+ by BNetzA should have consisted in assessing whether LRIC+ would be better suited than pure LRIC to meet the policy objectives.

Indeed, as BEREC has to assess the serious doubts based on the regulatory framework it cannot take the German law as its starting point of analysis.

2. Assessment on *The need to ensure that customers derive maximum benefits in terms of efficient cost based termination rates*

In order to assess the Commission's serious doubts on *the need to ensure that customers derive maximum benefits in terms of efficient cost based termination rates*, BEREC has divided its analyses into three parts: methodological issues, mobile to mobile competition issues and fixed to mobile competition issues.

[16] The costs of efficient service provision are derived from the long run incremental costs of providing the service and an appropriate mark-up for volume-neutral common costs, inclusive of a reasonable return on capital employed, as far as these costs are required to provide the service. Section 79 remains unaffected

[17] In the following we are referring to the document BK 3b-12/003 (non-confidential version of the draft remedy document)

a. Methodological issues on the LRIC+ approach chosen

This section concentrates on BNetzA's arguments referring to static efficiency, that is:

- how a competitive outcome would look like?;
- whether such a model would be appropriate taking into account the specifics of the termination service? and
- ways to contribute efficiently to a potential recovery gap?

Although not all of these issues are extensively discussed in BNetzA's draft decision, they are nevertheless relevant in the present case, as some of the underlying assumptions made by BNetzA seem questionable to BEREC. In addition, some important arguments in favour of pure LRIC – i.e. call externalities and utility distribution – do not seem to be adequately reflected.

Other relevant aspects (as mentioned in Art. 13, sec. 2 of the Access Directive), referring to dynamic efficiency and the competitive impact on other mobile operators, MVNOs, companies with a net-inflow or outflow of traffic, fixed networks and consumers are dealt within the following sections.

Views of BNetzA

After explaining the reasoning laid down in the Commission's Recommendation in favour of a pure LRIC price, BNetzA concludes that: "*In the present case, it cannot be proven due to general economic considerations or with a view on the special characteristics of the termination market that a competitive price for terminations would oscillate to LRIC levels than to CESP levels. A LRIC regulation cannot in anyway be justified from the perspective of emulating competitive prices.*"

BNetzA's general orientation when setting appropriate prices for the mobile termination service is the simulation of a competitive outcome (the "as-if competition price"[18]), which was the starting point of the discussion on allocative efficiency. This position is also supported by answer 2a of the first set of questions from the EWG in which BNetzA states that: "*Though in principle the costs of the termination service might be attributed not only to the calling party but also to the called party (cf. Rec 15 of the Termination Recommendation) there is no compelling evidence that in a competitive market the called party would actually be charged. Therefore it's not against the emulation aim if a mobile operator decides that the total unit cost should be borne by the calling party" (cg. 3.6.5.1.3.1.1.2 in the remedies draft).*"

And further, referring to the special characteristics of the termination service (section 3.6.5.1.3.1.1.2, p38 and 39 of the notified document) BNetzA explains: "*When two direct service receivers are present, an undertaking, such as the subject, principally has the option to demand a coverage amount for the unit costs of the service provided from both sides. An undertaking will preferably orient whether and how it distributes such a distribution to the respective price elasticities. […] In the present case, it is, however, not possible for the*

Deliberation Chamber to determine existing price elasticities of the wholesale buyers, calling end-users and called end-users behind them, in the case of competition (!). […] Even related to other parameters, which determine the level of price elasticities at the wholesale and end-user side, no data is available which would stand up to a serious load test. Therefore, there are no options to conduct a theoretically and/or empirically founded distribution of coverage loads from elasticity perspectives."

Concerning the appropriateness of applying a LRIC + (CESP) approach instead of the recommended pure LRIC approach, BNetzA finds (section 3.6.5.1.3.1.1.3, p.40-41 of the notified document): "*In comparison, traditional CESP is better suited than LRIC to represent the unit costs of an efficiently provided termination service. The decisive advantage consists in the fact that as per the CESP concept of termination service even the (wholesale-relevant and efficient) costs are allocated in a cause-specific manner to co-production. In this context, it needs to be shown that in the view of the Deliberation Chamber, there is no cause to consider services used purely internally to the network as main services and services sold externally to the network as additional services with the result that overheads would be borne only by the main services…*"

<u>BEREC's Assessment</u>

From a methodological point of view, BEREC would like to make the following comments on the starting point of BNetzA's analysis – "the emulation of a competitive outcome/as-if competition price" -:

- Even in highly competitive markets, it is not necessarily the case that a multiproduct firm will allocate joint and common costs with an (equal proportionate or volume proportionate) mark-up to all products offered. In many cases prices do only cover the incremental/marginal costs, to attract customers or following an optimisation calculus to achieve the best outcome in a two– or multi-sided market. So, although it is understood that on the whole (taken into account all products) the total (efficient) costs need to be recovered, this does not mean that each product will contribute - or even contribute equally - to achieve this.

- To take an emulated competitive outcome (the "as-if competition price") that also accounts for joint and common costs as starting point, would in BERECs view only be appropriate if the outcome was an efficient allocation (in terms of no welfare losses, ie. prices are reflecting marginal utilities). This is not the case with an equal proportionate mark-up as the termination service is a two-way access service[19] and encounters (under a CPP regime) an externality, which is not taken into account[20]. Not considering this market failure (call externality) when regulating MTRs, puts in doubt, whether BNetzA has sufficiently taken into account Article 13 section 2 of the

[19] Termination can be a one-way or a two-way access service. When networks with directly connected customers are involved, the access is of two-way nature (both operators are requesting from each other termination services and – if they are located in the same geographic market – are frequently in competition with one another). Carrier requesting termination without having customers directly connected (eg. C(P)S) are seeking a one-way access service. According to BNetzA (meeting with BNetzA on the 13th of March operators of this last mentioned group favoured pure LRIC over the pro-posed CESP approach.

[20] The argument that the calling party triggers the call and should hence bear the entire costs (according to the cost causation principle) in fact does not take into account this externality.

Access directive (transposed by § 30 sec. 3 (1) of the German Telecoms Act) that requires NRAs to ensure economic efficiency (and sustainable competition and maximise consumer benefits) when imposing obligations on an SMP undertaking in this market. To the extent that this market failure was not addressed, the proposed "as if – competition price" cannot be economically efficient. Competition aspects of the two-way access termination service will be discussed in the following sections.

- Applying the proposed CESP (LRIC+) method to the termination service does not only mean, that the whole cost of the call would be covered by the calling party (although the distribution of utility in most cases would be different), it also means, that the calling party is contributing to the recovery of the networks' joint and common cost of the terminating company. While it is agreed that the distribution of utility for the two parties involved in a call cannot be specified with certainty, the European Commission has taken into account this externality when developing the recommended approach. BNetzA neither in its proposed decision, nor on the answers to the EWG questions[21] elaborates on this key argument, but states on page 26 of the notified document, when discussing the pure LRIC concept that: "*As the case may be, a procedure using the Commission Recommendation implies that the wholesale buyer or caller still only contributes a supposedly relatively small part of cost coverage…*". In fact it is unclear on what basis BNetzA derives to this conclusion[22]. This was also noted by the European Commission in their serious doubt letter (p.7) were the Commission states: "*In particular, BNetzA's assertion that, due to its inability to determine with certainty existing price elasticities of wholesale buyers, calling end-users and called end-users, it cannot curtail the ability of SMP operators to recover common costs via call termination rates, neglects that a pure LRIC approach is better suited to facilitate a more efficient distribution of financial transfers between competing operators and thereby to a level playing field between all fixed and mobile operators.*" In addition it is to be noted that under a CPP regime, termination markets present the characteristics of natural monopolies, a situation which heavily impacts price elasticities in these markets. BEREC therefore agrees with the Commission's concluding statement "that BNetzA did not provide sufficient and compelling economic reasons to justify why it choose not to follow the Recommendation."

- Concerning BNetzA's argument that a CESP approach is better suited to represent the efficient unit costs, as cost are allocated in the cost specific manner of co-production, BEREC refers to the argument developed above, on the specific nature of the termination service and the market failure of call externalities which is not reflected in cost and prices. However, while the LRIC+ approach proposed by BNetzA covers the whole average costs per unit (although in an non-efficient way), the question needs to be answered how a difference between CESP and the pure incremental costs can be recovered (recovery gap) efficiently if the pure LRIC

[21] Number 15 of the answers provided by BNetzA to the EWG on 22 march does not refer to the EWG's methodological/economic questions on call externalities but instead explains in-principle legal issues that a regulated company cannot be subjected to compulsory requirements for reasons of proportionality.

[22] In their response to BERECs question whether they have also done a pure LRIC calculation with the WIK pure LRIC module, BNetzA stated "*…this module has not been run with the parameters fixed in the notified draft of the rates decision. Therefore we have no authoritative BU-LRIC results which could be shared*."

approach proposed by the European Commission was applied. First, one needs to take into account that a recovery gap resulting from a switch from CESP to pure LRIC can only emerge in case of a net-inflow of traffic[23]. Second, from an efficiency point of view, the most appropriate way to recover such a gap would be to let the operator decide on the basis of price elasticities - with the side condition that the common cost recovery should preferably come from markets/services with effective competition or from regulated wholesale services in a way that a negative competitive impact is minimized. Such a recovery would - from an efficiency point of view - be clearly preferable over a CESP based recoupment from termination, which does not address the market failure and hence does not aim to minimize the resulting efficiency losses and competitive effects. This was also reflected by BEREC in its opinion on Case NL2012/1284 – Fixed call termination Netherlands, where BEREC says (p. 13): "*There is an objective reason to recover common costs on retail markets rather than on the wholesale termination markets. By taking into account pure incremental costs when determining termination rates operators are being encouraged to recover their common costs on retail markets (on which there is a price constraint) and not on a monopolistic market (on which there is a risk of excessive prices).*"

- Concerning BNetzA's argument that *"The decisive advantage [of CESP over pure-LRIC] consists in the fact that as per the CESP concept of termination service even the (wholesale-relevant and efficient) costs are allocated in a cause-specific manner to co-production",* it has to be noted beforehand that costs in a telecom environment are not axiomatic, but are the direct result of the framework for regulatory costing, of accounting principles as well as their application. Secondly, the framework for regulatory costing has at the same time to reflect market circumstances, address their failures and promote efficiency. Therefore reducing the efficiency analysis to a rather specific interpretation of cost causation (i.e. the question who is triggering the service), is not sufficient in that it does not take into account the specific nature of the termination service. All the more that a causation analysis could all the same conclude that the cost is triggered by the called-party replying the call, and would therefore allocate the cost of the called-party. If regulation is needed, it is therefore more efficient to follow an approach which explicitly takes into account the existence of a market failure (externality).

Based on this reasoning, BEREC notes that it cannot follow BNetzA's reasoning that LRIC + (CESP) would be a more appropriate costing methodology than pure LRIC to calculate efficient termination prices.

However, these conclusions are drawn on pure methodological reasoning and the following sections explore in more detail the likely effects on competition and the empirical evidence that has been put forward by BNetzA why the effects on competition are in fact not - or at least decisively less - relevant in the German context.

[23] In case of a net-outflow, a lower termination rate would be beneficial for the operator. This is frequently the case with smaller networks and is also noted in Recital 3 of the Termination Recommendation. In case of a net-inflow revenues are cut and must hence be recovered from other services.

b. Competition Effects: The Mobile to Mobile case

<u>*Concerns of the Commission*</u>

In general terms, the arguments put forward by the European Commission in support of the pure LRIC approach, in terms of competition between mobile operators, are centred around the link between high termination rates, on one hand, and the capacity of smaller or alternative operators to effectively compete at the retail level, on the other hand. In the words of the European Commission, and as stated in the Explanatory Note of the Recommendation[24] "(a)*bove-cost termination rates can give rise to competitive distortions between operators with asymmetric market shares and traffic flows. Termination rates that are set above an efficient level of cost result in higher off-net wholesale and retail prices. As smaller networks typically have a large proportion of off-net calls, this leads to significant payments to their larger competitors and hampers their ability to compete with on-net/off-net retail offers of larger incumbents. This can reinforce the network effects of larger networks and increase barriers to smaller operators entering and expanding within markets.*"

It is the understanding of the European Commission that "(t)*he further termination rates move away from incremental cost, the greater the competitive distortions become* (…)". In particular, "*termination rates which approximate the long-run incremental cost of providing the service can be expected to lead to enhanced competition and lower retail tariffs across the range of consumers, while still facilitating efficient cost recovery and appropriate investment incentives.*"

In addition to the competitive distortions identified in the first paragraph, in the presence of a call externality, as discussed in some more detail in the section on methodological issues above, the European Commission refers to the economic literature to note that "*mobile networks have strong incentives to implement on-net/off-net price differentials* (…)" and that "(t)*his theory suggests that mobile call termination charges above marginal costs can lead to permanent net payments by smaller networks and, since off-net prices are set above costs, also implies that smaller networks receive relatively fewer calls.*"

In this specific case, the Commission does not share BNetzA's assertion that its proposed method is better suited to serve the policy objectives of promoting competition and the interest of citizens of the EU as it would not lead to a situation of over-recovery of costs. Furthermore, the Commission does not agree with BNetzA's assertion that the "recovery gap" between the proposed LRIC+ approach and a pure BU-LRIC methodology would be closed by the regulated operators through an increase in prices for their end-users. On the contrary, the Commission argues, evidence gathered so far appears to confirm the Commission's original expectation that the introduction of wholesale MTRs based on a pure BU-LRIC method results in significant consumer welfare gains.

[24] Available from http://ec.europa.eu/governance/impact/ia_carried_out/docs/ia_2009/sec_2009_0600_en.pdf. All references in current and following two paragraphs are taken from this document.

Views of BNetzA

BNetzA argues that the arguments put forward by the European Commission cannot be confirmed for the German case. The reasoning is mostly based upon the following four arguments:

- Smaller network operators have not expressed their support for the pure LRIC cost model, instead favouring the LRIC+ (section 3.6.5.1.3.1.2.2.1 Capital Outflow, page 45 of the notified document);

- Smaller network operators (E network operators) have been able to continuously gain market share even under the application of a LRIC+ based tariffs. In addition, BNetzA notes, Germany has one of the healthiest market structures with an applicable Herfindahl-Hirschman-Index (HHI) of only 2709 at the end of the second quarter of 2011, not very far from the minimum possible for four players (2500) (section 3.6.5.1.3.1.2.2.1 Capital Outflow, pages 45 and 46 of the notified document);

- BNetzA notes that it is currently not clear what role on-net/off-net price differentiations still play in the German market (references in this paragraph relate to section 3.6.5.1.3.1.2.2.2 Competitive behaviour of other mobile operators, page 46 of the notified document, and section 3.6.5.1.3.2 Protection of user and consumer interests, page 47). BNetzA notes that the on-net/off-net differentiation can only be monitored in a restricted manner at present within the mobile network sector, and that, in many cases, end-users are already offered a number of all-net tariffs at present, including those in flat-rate form[25] (it has been stated to the EWG that more than 70% of the mobile domestic calls in 2011 and 2012 account for unlimited tariff plans). The German regulator concedes that there are certainly still asymmetric traffic flows between larger and smaller mobile operators (which stand in a ratio of 2:1 to the detriment of smaller operators), and that the relative payment burdens of the smaller operators would thus fall in the case a pure LRIC regulation is used. However, BNetzA goes on to argue, the fall on payments made by the smaller operators need to be weighed against the charges of the smaller network operators, which should also be regulated by a pure LRIC approach. In particular, due to their lower advantages of scale compared to the larger operators, BNetzA continues, smaller operators could be forced to price their other services, including the origination services, significantly higher to cover their overheads. Ultimately, BNetzA claims that given that each network operator would have to develop its own strategy to cover any shortfall arising from the call termination segment, it would be impossible to predict which areas – business customers, prepaid residential customers, post-paid residential customers, infrequent users etc. – would be subjected to extra costs and to what extent;

- BNetzA continues, it cannot be proved that in case of a pure LRIC price cap on the part of smaller network operator, the result would actually be significant reductions of

[25] The EWG has learned, based on further information provided by BNetzA, that the latter's understanding of flat-rate seems to include also tariffs with an included but limited threshold of minutes of communications, which seems to be at odds with the usual definition of flat-rate.

the off-net prices (section 3.6.5.1.3.1.2.2.2 Competitive behaviour of other mobile operators, page 46 of the notified document).

BNetzA concludes (section 3.6.5.1.3.1.3 Result, page 47 of the notified document) that a reduction of the MTR to the level which resulted from the application of a pure LRIC model is not advisable in view of the competitive objective, a reasoning which, in BNetzA understanding, is also supported by the fact that a rate based on the pure LRIC would likely be subjected to higher legal risks than a LRIC+ model.

BEREC's Assessment

First of all, BEREC considers that in principle the application of symmetrical termination rates promotes efficiency, sustainable competition and maximises consumer benefits in terms of price and service offerings. BEREC welcomes that BNetzA is committed to the setting of symmetric MTRs.

Regarding the specific arguments put forward by BNetzA, BEREC has the following analysis:

- The fact that all mobile network operators were against the application of a pure LRIC methodology in Germany seems to contradict the presumption that such methodology favours smaller operators and contributes to a reduction of the barriers to expansion, and it could point to that the German market exhibits no market failures of the sort of the ones mentioned before in this section. In fact, the German experience seems to go against the practice in most countries that, so far, have implemented a pure LRIC methodology, where small existing mobile operators, both network and virtual and new entrants have usually declared their relative preference for such methodology. What BEREC notes from the data provided by BNetzA, either in its notified document or on the answers to the EWG question, is that **[redacted]**. Thus the financial imbalance that a small mobile operator could face (if it receives less traffic than it sends) if the tariff is set based on a LRIC+ approach, when looking only the mobile traffic flow, is to be compensate by the fixe to mobile traffic flow. This explains why the smallest MNO would be better off with a LRIC+ based tariff. Moreover, it appears that three of the four MNO being fixed and mobile integrated operators, part of their traffic being *intra-group,* may also help to explain the position of smaller mobile operator for a preference with LRIC+ based tariffs. Finally, economic literature also points to the possibility, under certain circumstances, that high termination rates favour a less competitive equilibrium in the retail market – which could also explain mobile operators' preference for LRIC+ instead of pure LRIC. In any case, BEREC has found no convincing reasons, in the fact that mobile network operators did not oppose a LRIC+ methodology, to contradict the presumption that an MTR set at the incremental level reduces the barriers to entry and to expansion and that it does not favour a level playing field within the mobile sector, considered in isolation (see above). Likewise there are effects on the fixed networks – even if there the same LRIC+ approach was applied. These issues are discussed in the next section;

- One needs to point out that only one autonomous full-MVNO is present in the market (Lycamobile), an operator which typically concentrates on the international calls segment. One might also note that the capacity of smaller network operators, present in the market for more than 10 years, to gain market shares does not mean that a new network operator, or an MVNO, would have the capacity to profitably enter the market at the prevailing penetration rates, especially if they engage in a commercial strategy based on low off-net prices. Finally, the fact that market shares of existing mobile network operators are relatively close does not necessarily prove that the market is competitive, especially in what regards contestability, that is, the mentioned ability of a new operator to enter the market – indeed, it may, under certain circumstances, contribute to work against that ability;

- The evidence presented by BNetzA, namely the existence of a 2:1 ratio of mobile-mobile traffic imbalance to the detriment of smaller operators does not allow one to reject the relevance of *on-net*/*off-net* price differentiations in the German market, especially given the increasing share of *on-net* traffic[26]. On the other hand, all else constant, and in the presence of a traffic imbalance to the detriment of smaller operators, a reduction in the mobile termination rate improves the net financial deficit that smaller operators face vis-a-vis larger operators. This improvement means that, contrary to what BNetzA claims, it will be easier for smaller operators to cover non-incremental costs in the presence of lower mobile termination rates, than the opposite;

- It is well established in the economic theory that marginal costs directly influence prices. A reduction on mobile termination rates are entirely translated into lower marginal costs of providing an *off-net* call. From a theoretical standpoint, there are no reasons why not to expect lower prices for *off-net* calls in the presence of lower mobile termination rates, in a competitive market. In particular, and as BEREC's opinion on case NL/2012/1285 stated, "…*operators have a disincentive to lower their off-net call prices because by so doing they generate more outbound traffic which attracts outpayments to rivals. If termination rates decrease, the cost of terminating calls decreases for each operator and retail price competition increases as operators have stronger incentives to reduce their call charges. Lower termination rates would increase competition in call charges, so pure BULRIC delivering lower termination rates should be preferred in general to plus BULRIC. Pure BULRIC is therefore generally more appropriate to promote competition and to ensure that users derive maximum benefit in term of price*". The evidence provided by BNetzA does not allow to reject this assertion.

- BEREC also considers that the application of a pure LRIC approach contributes to reflect the true value of the resources used at the margin for the provision of an *off-net* call. This will contribute to approximate the marginal costs of an *on-net* and of an *off-net* call, which, in turn, should contribute to the emergence of flat-rate tariffs or bundles with a larger content of "free" communications. Competition based upon more "realistic" price signals, which reflect the true scarcity of the resources used, should be welfare enhancing for consumers and contribute to higher levels of usage of mobile communications.

[26] On-net traffic share in total outgoing increased from 35% of the total outgoing traffic in 2005 to nearly 50% in 2010 (3.6.5.1.1.2, p33 of the notified document)

Taking all this into consideration, BEREC also agrees with the European Commission that the application of a pure LRIC model will contribute to increased welfare gains to the consumers, which is of paramount importance bearing in mind the content of Articles 8(4) and 13(2) of the Access Directive and Article 8 of the Framework Directive. These gains will be due to, on one hand, to increased levels of allocative (static) efficiency in the overall market (as seen in the previous section), which will tend to be passed on to consumers in competitive markets, and, on the other hand, to increased levels of competition in the market. This effect, in the understanding of BEREC, will prevail over the potential "waterbed effect". The risk that BNetzA mentions – namely the risk that it is unforeseen which classes of consumers would bear the costs of a potential "recovery gap" – is, in the opinion of BEREC, lower than the risk of applying a cost model which fails to address the market failures present in the market.

For the reasons stated above, BEREC agrees with the European Commission that no arguments have been put forward by BNetzA that would allow concluding that a LRIC+ methodology would be better suited than a pure LRIC one, in what regards competition between mobile operators and the interests of consumers of mobile services.

c. Competition Effects: The Fixed to Mobile case

Concerns of the Commission

The Commission observes that mobile termination rates based on a pure LRIC cost standard would contribute to a level playing field among operators by eliminating fixed-mobile competitive distortions, and thus the Commission considers that BNetzA's LRIC+ cost model may "*lead to competitive distortions between fixed and mobile markets and, ultimately, lead to the application of consumer tariffs, which are based on wholesale inputs above avoidable costs*".

Moreover, the Commission notes that competitive distortions between fixed and mobile markets may appear, taking the form of cross-subsidisation between fixed network operators and mobile network operators

Views of BNetzA

BNetzA argues that, in its point of view, a LRIC+ approach is better suited to promote fixed-mobile competition for the following reasons:

- Germany's fixed line markets exhibit healthy competition, so much so that it exerts strong pressure for cost efficiency on the use of fixed network services. By implication, this goes to suggest that a reduction in MTRs would not have any material additional positive impact on dynamic efficiency of fixed market structures.

- Past experience shows, that cuts in MTRs are less likely to pass-through to the end user in terms of lower retail fixe to mobile (FTM) call rates than in terms of lower access charges, both for PSTN or broadband[27].

- In the circumstances, the imposition of non-cost-covering prices on mobile operators by means of a pure LRIC approach would therefore not be reasonable and justified.

- It is considered that a reduction in MTRs set through the pure LRIC approach is not likely to reverse current fixed to mobile traffic trends and is therefore not likely to have an impact on the dynamics of fixed-mobile competition.

BEREC's Assessment

Regarding the specific arguments put forward by BNetzA, BEREC has the following analysis:

- In view of the fact that termination markets frequently represent a situation of two-way access, the setting of MTRs would have strategic and competitive implications on fixed-mobile competition.

In general, MTR include part of the access costs of mobile networks that are therefore recovered from fixed callers, whereas, on the other hand, access costs of fixed networks are recovered through retail charges.

BNetzA's proposed LRIC+ model does in fact include non-traffic related (i.e other than coming from third parties) costs in the calculation of wholesale call termination, meaning that MTRs would be set above the level of avoidable costs compared to a pure LRIC approach. Because of a different treatment of the access network and the different sensitivity of the mobile access networks to traffic levels (as compared with fixed networks), use of LRIC+ means that mobile operators are allowed to recover from regulated termination a much higher cost base than a fixed operator. This would entail MNOs in Germany to recover a larger proportion of the costs of their access networks through regulated services at the expense of fixed operators, and ultimately consumers, while at the same time all the fixed access costs are recovered on the competitive retail side, from the same fixed consumers. Such a situation underestimates the competitiveness of the mobile operators, is detrimental to the level playing field between fixed and mobile operators and could fuel fixed-to-mobile substitution. Moreover, the different regulatory treatment of the access network implied by the use of the LRIC+ to set termination rates could explain a phenomenon observed by BNetzA, notably the fixed operators' propensity to use the savings from lower MTRs to lower the prices for their access services, instead of lowering prices of fixed to mobile calls.

It is also likely that MTRs set on a LRIC+ approach exacerbates the decline in FTM traffic, which is reported to have declined from 17.7 billion minutes in 2007 to 15.63 billion minutes in 2010. Given that mobile to fixed (MTF) traffic has consistently increased during the same period (24.60 to 32.95 billion minutes), and assuming that such positive trends are

[27] *All this suggests that the savings of the fixed-line network operators targeted in the termination area have mainly flowed into bundled pricing* (3.6.5.1.1.2 page 34 of the notified document**)**

maintained, the application of a LRIC+ approach is likely to consolidate the net flows of revenues from fixed operators to mobile operators, given the proposed asymmetry levels between MTRs and FTRs in Germany of 1,49 €c/min (based on the proposed level of MTR, 1,79 €c/min and FTR average of 0.3€c/min between peak and off-peak) .

- BEREC also shares the opinion of the EU Commission that LRIC+ may raise the risk of having operators charging inefficient high MTRs and thereby disincentivising operators from offering lower fixed to mobile call prices or flat rates.

Fixed operators are generally constrained to some extent in their ability to offer flat rates for mobile call services as part of their flat-rate packages, due to MTRs being significantly higher than FTRs (as seen above).

A pure LRIC approach in delivering lower MTRs, along with the application of symmetrical rates, is then deemed to be more appropriate in enhancing the ability of fixed operators in competing with lower fixed to mobile tariffs and in ensuring that end-users derive maximum benefit in terms of choice, price and quality of service.

Indeed, MTRs set based on a pure LRIC methodology may incentivise fixed operators to launch innovative retail plans/bundles that may include unlimited and/or cheaper call rates. For example, fixed operators may consider including cheaper or larger /bigger in-bundle FTM calls.

- The overall implication of BNetzA's argument that the pass-through of previous reductions in MTRs has been incomplete in terms of retail mobile and fixed call rates does not prove that MTRs set on pure LRIC would not maximise consumer welfare. This is because BNetzA itself recognizes that termination rate reductions are partially reflected in lower retail mobile call tariffs but also in the main channelled back to fixed consumers in terms of lower access charges or fees (either for PSTN or broadband access).

This in itself reinforces the case for potentially lower MTRs based on a pure LRIC approach, and is to be added to the previous arguments that it would allow fixed operators to launch more innovative retail offers.

Furthermore, given the higher net flow of revenues from fixed operators to mobile operators implied by the use of LRIC+ as opposed to pure LRIC, as well as the level playing field introduced by pure LRIC in the regulatory treatment of the access networks and the stronger retail competition, BEREC does not see how a pure LRIC approach would not provide more incentives for NGN/NGA investments from the part of fixed operators.

- BEREC notes that the integrated fixed and mobile operators have [**redacted**]% of the total market share, measured by terminated mobile traffic. This means that some operators are only present on the fixed market (case of operators being only present on the mobile market was addressed above), and in principle should, in order to reduce their mobile termination payment, be in favour of a pure LRIC approach.

As explained by BNetzA itself, in an answer to the EWG questions, this approach was requested by the fixed operators with no mobile branch, but it has not been specifically addressed by BNetzA in a sense that it has not estimated the financial impact for those operators to set MTR based on pure LRIC approach rather than LRIC+ approach.

BEREC then estimates that using a LRIC+ approach to set the MTR would lower the competitive situation between integrated fixed and mobile operators and fixed only operators since the latter would have to pay higher tariffs than if the MTR would be set using a pure LRIC approach, and that all that traffic would be off-net.

For the reasons stated above, BEREC agrees with the European Commission that no arguments have been put forward by BNetzA that would allow concluding that a LRIC+ methodology would be better suited than a pure LRIC approach, in what regards competition between fixed and mobile operators and the interests of consumers of fixe services.

Indeed, BEREC is of the opinion that the pure LRIC approach is more effective in ensuring lower MTRs that would contribute to a more level playing field between fixed and mobile operators, and which would also encourage a greater usage of telephony services, thereby increasing overall consumer welfare.

d. Summary

BEREC's analysis of LRIC+ and pure LRIC clearly indicates that setting German MTRs on the basis of pure LRIC cost model provides a better outcome in terms of allocative and dynamic efficiency. In the circumstances and with the data available at hand, pure LRIC best promotes mobile-mobile and fixed-mobile competition and should ensure that German customers derive maximum benefits in terms of efficient cost-based termination rates.

BEREC therefore shares the Commission's view that the arguments put forward by BNetzA as to the suitability of the LRIC+ approach, to set the MTR, to meet the policy objectives set out in Article 8 of the Framework Directive are not justified, and is neither compatible with article 8(4) and 13(2) of the Access Directive.

3. Assessment on *Creation of barriers to the internal market*

Concerns of the Commission

The Commission is concerned that higher termination prices set by the BNetzA on the basis of LRIC+ costing methodology may create barriers to the internal market as the terminating operators in Germany will be able, on the basis of the calling party pays principle, to benefit from this (higher) rate at the expense of the operators, and ultimately the consumers, in the Member State from which the call originates where termination rates are set using the pure LRIC costing methodology. Moreover, the Commission observes that mobile 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.

Furthermore, the Commission does not share BNetzA's assertion that the third policy objective of Article 8(3) of the Framework Directive is subordinate to the other two. In the light of this, a "competition of systems", as suggested by BNetzA, would be detrimental to furthering the internal market, as it would create exactly the type of inward-looking national assessment that Article 8(3) of the Framework Directive attempts to prevent.

Views of BNetzA

BNetzA has provided that only 2% of all traffic terminating in Germany actually originates abroad. Although numbers broken down for single countries are not available, BNetzA estimates that due to the strong Turkish and Russian communities in Germany and the strong commercial ties with Asian and American countries, only a small part (less than 1%) could come from the EU Member States.

BNetzA argues that other NRAs have to check whether a recommended approach blends well with the national circumstances and they have the right and the obligation to deviate from a Recommendation as far as it is required by these national circumstances. This “one size fits all” approach contradicts the non-binding and flexible nature of a Recommendation (see Article 19(2) of the Framework Directive). In BNetzA’s view, the NRAs need to retain at least some discretion in regulating the markets since otherwise they couldn’t fulfil their task to regulate a market according and proportionate to each market situation on a case-by-case basis.

Moreover, in its notification BNetzA states that with regards to the policy objective of contributing to the development of the internal market, the proposed approach is preferable, as a pure LRIC approach would not serve better the internal market objective, as it would not, in BNetzA's view, be better suited to achieve the other two policy objectives (promote competition and maximize consumer benefits), thus denying the self-standing importance of the objective to contribute to the internal market[28].

BEREC’s Assessment

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

As stated above, BEREC considers that policy objectives stated in Article 8 of the Framework Directive have an equal weight, so, that promoting competition is as important as

[28] In response to the Commission's request for information, BNetzA adds that the policy objective of contributing to the internal market under Article 8 (3) of the Framework Directive is not on an equal footing but committed and subordinate to the other two policy objectives of promoting competition, Article 8 (2) of the Framework Directive and promoting the interests of citizens of the EU, Article 8 (4) of the Framework Directive. In addition, in its response to the Commission's request for information, BNetzA advises the Commission to accept the "competition of [regulatory] systems" ("Wettbewerb der Systeme") inherent in its approach, as it leads to market results beneficial for Germany.

maximizing consumer benefits which is also as important as contributing to the internal market.

As stated in previous BEREC's opinion on phase 2 cases relating to MTRs, concerns in relation to the creation of internal market should not be based on the level of TRs (mobile or fixed), to the extent that the same tariff is charged to national or cross-borders operators, and to the extent that the recommended methodology, pure LRIC, has been used.

As assessed in the previous part, BEREC considers that the most efficient cost methodology to be used in order to meet the policy objectives is pure LRIC.

Here, operators from other EU Member States where termination rates are based on a pure LRIC methodology, will be forced to pay higher termination prices to German operators in case LRIC+ approach is employed, which would be twice as high the average pure LRIC tariffs from other countries that have set tariffs based on pure LRIC (via a bottom-up model or by benchmarking)[29]. These higher and asymmetric wholesale costs will translate into higher retail prices in competitive retail markets in other Member states.

In addition, higher wholesale charges can present potential side-effects of distorting consumer behaviour and amplifying the deficits in the international traffic balance of German mobile operators[30]. Moreover, given the relative size of the German market, significantly higher termination prices to German operators in case of LRIC+ could have a negative effect on the development of pan European offers (uniform pricing schemes for international calls to mobile networks across the EU).

As a national circumstance, BNetzA, provided a figure according to which the traffic coming in to German mobile networks from foreign EU networks could be less than 1% in terms of percentage, thus would not lead to have a detrimental effect to the development of the internal market. However, BEREC estimates that in terms of terminated minutes for some Member States it could constitute quite substantial share of outgoing traffic to German mobile networks. In particular for Member States where outgoing traffic mainly flows to German mobile operators this could lead to the negative situation previously discussed for operators from other EU Member States if termination rates where to be set based on different cost methodology. Moreover, BEREC is of the opinion that unjustified asymmetries in termination rates across the EU will lead to cross-subsidy of national operators by foreign operators and ultimately consumers. Since in the present case it has already been found that deviation from the pure LRIC approach is not adequately justified and considering that LRIC+ leads to significantly higher rates, the eventual use of LRIC+ methodology to set mobile termination rates in Germany will lead to cross subsidies of German operators at the expense of foreign operators and consumers.

In order to ensure a correct and coherent interpretation and application of the relevant provisions of the Regulatory framework, the Commission has adopted the Termination Rates Recommendation, setting out a consistent approach that the NRAs should in principle follow

[29] For example the 5 most populous Member States (leaving aside Germany itself) are all applying a pure BU-LRIC rate: FR (FR/2011/1200) with a target rate of 0.80 €ct/min; IT (IT/2011/1219), 0.98 €ct/min; ES (ES/2012/1291), 1.09 €ct/min; UK (UK/2010/1068), 0.86* €ct/min; PL (PL/2012/1368), 1.04* €ct/min (*depending on exchange rate).

[30] The deficit of the international traffic balance of German mobile operators (outgoing traffic from German mobile networks to foreign networks – incoming traffic from foreign networks to German mobile networks) increased from 6% in 2006 to 46% in 2010

regarding price control obligations for fixed and mobile termination rates. Moreover, these services are among the key tools in the hands of NRAs to promote regulatory objectives. Thus BEREC notes that other NRAs implementing pure LRIC methodology rely also on the harmonisation approach and on the fact that divergences in implementation by the NRAs – except when duly and precisely justified, including through taking into account the impact on the internal market and other member states - may create a barrier to the internal market. Otherwise other NRAs couldn't ensure that the customers derive maximum benefits in terms of efficient cost-based termination rates. Therefore contribution to the development of the internal market can't be regarded as less relevant than the other policy objectives and thus it cannot be an argument to deviate from the recommendation.

In light of the aforementioned, BEREC is of the opinion that the proposed approach by BNetzA will create a barrier to the internal market, and therefore shares the Commission serious doubts.

5. CONCLUSIONS AND RECOMMENDATIONS

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 European 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.

Regarding the policy objectives set out in Article 8 of the Framework Directive, BEREC is of the opinion that they must have an equal weight, so, that promoting competition is as important as maximizing consumer benefits which is also as important as contributing to the internal market.

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) BNetzA's proposed MTRs are not based on a pure LRIC costing methodology, as recommended by the Commission based on the economic analysis that show that pure LRIC results in a better competitive outcome, and (ii) BNetzA has not provided a valid justification for deviating from the EC recommendation and in particular, has not provided evidence to support its view that applying pure LRIC based tariffs would have a disproportionate effect on German operators and that LRIC+ methodology would be better suited to meet the policy objectives of promoting efficiency and sustainable competition and maximize consumer benefits than the pure LRIC. BNetzA therefore did not prove that national circumstances justify the deviation from the recommended MTR costing methodology.

In addition, BEREC shares the Commission's concerns that BNetzA proposal could create barriers to the internal market if other NRAs set MTR based on the methodology recommended by the Commission (via a bottom-up model and by benchmarking) and BNetzA deviates from that methodology without valid justification. Moreover, BEREC considers that, since the 2014 tariffs are also based under a LRIC+ approach, such barriers would not only be limited to the year 2013.

BEREC recommends that BNetzA set the tariffs of the mobile termination rates, of the operators designated as having SMP in the market for wholesale voice call termination on their respective individual mobile networks, on the basis of a pure LRIC costing methodology, without any glide path.