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/2013/1430

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

17 May 2013

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1. EXECUTIVE SUMMARY

On 6 March 2013, the Commission registered a notification from the German national regulatory authority, Bundesnetzagentur (BNetzA), concerning the market for call termination on individual public telephone networks provided at a fixed location in Germany (corresponding to market 3 in Commission Recommendation 2007/879/EC of 17 December 2007)[1].

In the present notified draft measures, BNetzA proposes to impose on the Deutsche Telekom (DT)[2] the following obligations: (i) interconnection and conveyance obligation, (ii) co-location obligation for interconnection purposes, including the obligation to give colocation users access to facilities at all times, (iii) obligation to ensure that access agreements are based on objective criteria, are transparent, grant equally good access and meet the requirements of fairness and reasonableness, (iv) obligation to submit the access agreements to BNetzA, (v) obligation to publish a reference offer, and (vi) price control obligation.

With regard to the obligation of cost-orientation, BNetzA proposes to set (retrospectively, as of 1 December 2012) the following fixed termination rates for DT: 0.36 €c/min (peak) and 0.25 €c/min (off-peak). These rates are to be applied until 31 December 2014 and in BNetzA view are calculated based on a LRAIC+ cost methodology[3].

On 8 April 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. Commission's doubts relates to the compatibility with EU law of BNetzA's proposed measures concerning price control remedies for the wholesale markets for call termination on individual public telephone networks at fixed locations in its current form, due to the methodology used to calculate the costs of services.

In particular, the Commission expressed serious doubts as to the compatibility of the draft measures with the requirements of the 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.

BEREC considers that under Article 19 of the Framework Directive, a NRA can deviate from a recommendation, here the Commission Recommendation 2009/396/EC on the Regulatory Treatment of Fixed and Mobile Termination Rates (hereinafter referred to as The

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[1] On the same date BnetzA registered a notification concerning the market for call origination on the public telephone network provided at a fixed location in Germany, case DE/2013/1429. As this notification was closed with no comments from the Commission, the present opinion does not concern this case.

[2] In a sepparate measure, 56 other operators were previously designated as having SMP on their relevant markets for call termination at a fixed location.

[3] In its comments to the present notification, the Commission urged BnetzA to notify draft measures with respect to all designated SMP operators in the fixed voice call termination markets without undue delay, in order to achieve symmetrical FTRs based on the recommended BU-LRIC methodology. As these comments are not part of the SDL, they were not analysed in the present opinion.

Termination Recommendation), in the condition that it shall inform the Commission giving 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 BNetzA's proposed FTRs from December 2012 until December 2014 are not based on a pure LRIC costing methodology and no valid justification has been provided for such deviation.

According to 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, while according to articles 2 and 6 of the Termination Recommendation the cost of efficient service provision for fixed termination rates is the pure BU-LRIC. Therefore, under the current framework, a NRA who wants 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 of the Framework Directive.

In BEREC's opinion, BNetzA has not provided valid justifications to deviate from the Termination Recommendation. In particular, BNetzA has neither proved that the potential impacts of applying pure BU-LRIC based tariffs on German operators and/or consumers would justify a departure from pure BU-LRIC, nor has it proved that its proposal 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.

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 without valid justification, whose application leads to significantly higher FTR in Germany as compared with the average pure BU LRIC tariffs of other countries that have set tariffs based on pure LRIC (via a bottom-up model or benchmark)[4].

BEREC suggests that BNetzA set the fixed termination rates for Deutsche Telekom AG, at the level of pure BU-LRIC costs, without any glide path[5].

2. INTRODUCTION

On 6 March 2013, the Commission registered a notification from the German national regulatory authority, Bundesnetzagentur (BNetzA), concerning the market for call termination on individual public telephone networks provided at a fixed location in Germany (corresponding to market 3 in Commission Recommendation 2007/879/EC of 17 December 2007). On 15 March 2013, a request for information (RFI) was sent to BNetzA followed by an additional request dated 19 March 2013 and responses were received on 20 March 2013 and 21 March 2013.

[4] simple average of 0,1171 eurocents for pure LRIC based fixed termination rates already notified, i.e. in France, Denmark, Ireland, Malta and Bulgaria

[5] An eventual glide-path driven by the transition to NGN might in certain circumstances be justified, as long as it is captured under a pure BU-LRIC costing methodology.

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 8 April 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 15 April 2013 the EWG sent a first list of questions to BNetzA. Answers were received from BNetzA on 17, 18 and 23 April 2013. Additional questions were sent on 22 April 2013 and the answers received on the 23 April 2013.

The EWG met on 17 April 2013 in Bucharest with the objective to share understanding on the notified documents and 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 and analysis of the relevant documents were required on others.

Because the representatives of BNetzA were not able to participate at the EWG meeting in Bucharest, the EWG held a conference call with BNetzA on 23 April 2013 to gather further information and clarification on the questions sent and answers received. The BNetzA statement during the conference call was also sent to the EWG by email on 24 April 2013.

A draft opinion was finalised on 10 May 2013 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 17 May 2013.

3. BACKGROUND

Previous notifications

The third round of market analyses of the market for call termination on individual public telephone networks provided at a fixed location in Germany was previously notified to and assessed by the Commission under DE/2012/1359[6]. At the time BNetzA notified its proposal for market definition and the assessment of significant market power (SMP).

BNetzA proposed to define markets for call termination on individual public telephone network at a fixed location including call forwarding. Only services allowing for the termination on the lowest interconnection level were covered by the market definition. BNetzA proposed to designate 57 operators as having SMP on their relevant markets.

The Commission had no comments as to the market definition and the SMP assessment with respect to the market for wholesale fixed call termination.

Current notification

In the currently notified draft measure BNetzA proposes to impose on Deutsche Telekom AG (DT) the following obligations (i) interconnection and conveyance obligation, (ii) co-location obligation for interconnection purposes, including the obligation to give colocation users

[6] C(2012)5904

access to facilities at all times, (iii) obligation to ensure that access agreements are based on objective criteria, are transparent, grant equally good access and meet the requirements of fairness and reasonableness, (iv) obligation to submit the access agreements to BNetzA, (v) obligation to publish a reference offer, and (vi) price control obligation.

Costing methodology for fixed termination rates

With regard to the obligation of cost-orientation, BNetzA proposes to set (retrospectively, as of 1 December 2012) the following fixed termination rates (FTRs) for DT: 0.36 €c/min (peak) and 0.25 €c/min (off-peak). These rates are to be applied until 31 December 2014.

As part of the current notification BNetzA sets out draft measures which describe elements of the cost model used for the calculation of wholesale voice call termination charges for DT.

According to BNetzA, proposed FTRs are based on a LRAIC+ cost model. BNetzA also indicates in the draft measure that its approach is not in accordance with Recommends 2 and 6 of the Termination Recommendation. Thus, with the cost methodology employed, NGN CAPEX (capital costs) are set on the basis of a bottom-up modelling approach, while other cost elements such as OPEX, rental costs product/supply costs related to technology and distribution, common costs, as well as specific PSTN costs, are taken from DT's regulatory accounts. In doing so, BNetzA includes in its relevant cost stack both "traffic-related" costs as well as "non-traffic related" common costs which could be attributable to services other than wholesale voice fixed call termination.

Also, BNetzA explains that while the bottom-up cost model is NGN-based and uses current costs, the proposed FTRs also allow for the recovery of PSTN costs in order to comply with the German telecommunication law (TKG) according to which BNetzA has to ensure cost-recovery of DT's costs incurred for running its actual network (the majority of which is still PSTN-based). According to BNetzA, the non-inclusion of PSTN costs would not permit on-time migration to a full NGN core network.

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 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 a core part of the Termination Recommendation by alleging that the LRAIC+ approach will contribute to the development of the internal market and is better suited to meet the policy objectives provided for in Article 8(1) of the Framework Directive and in Article 8(4) of the Access Directive. Further to this, according to BNetzA pure BU-LRIC would neither better support the interest of other fixed operators or those of citizens and end-users. Finally, BNetzA considers that calculation of fixed rates according to pure BU-LRIC would increase the difference between mobile and fixed termination charges and that the LRAIC+ approach for setting FTRs is better suited to reduce the gap between FTRs and MTRs. Applying pure BU-LRIC would, according to BNetzA, significantly reduce the revenues of fixed operators, thus hampering their investment capacities.

With respect to the other operators already identified with SMP on their respective fixed voice call termination markets, BNetzA plans to notify corresponding regulatory measures in the next future. Whilst BNetzA indicates that the other SMP operators will be subject to reciprocal prices with DT, thus leading to the application of symmetrical FTRs across Germany, when the resulting price control obligations would be implemented has not been indicated.

Commission's serious doubts

The Commission expresses serious doubts regarding the remedies on the market for wholesale voice call termination on individual fixed 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 underlines that, given the characteristics and the associated competitive and distributional concerns of termination markets[7], the objectives of promoting efficiency and sustainable competition, maximizing consumer benefits and contributing to the development of the internal market would best be achieved by a cost orientation obligation remedy based on a pure BU-LRIC methodology and a narrow definition of the increment. 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. Also the Commission reminds that, when deciding on the correct level of the regulated wholesale termination rate, it is essential to ensure that the methodology promotes efficient production and consumption decisions and minimizes artificial transfers and distortions between competitors and consumers.

The Commission recognised that NRAs can deviate from the Termination 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 considers that the measures contained in BNetzA's draft decision do not appear to comply with these principles and objectives set out in the regulatory framework and that the departure from the pure LRIC costing methodology is proposed without providing sufficient reasons that the LRAIC+ methodology would be better suited to promote efficiency and sustainable competition and to maximise consumer benefit in the German market. Also the Commission notes that BNetzA proposes to base the FTRs on a LRAIC+ methodology which – contrary to Recommends 2 and 6 of the Termination Recommendation – allocates non-traffic related costs to the provision of the fixed termination service.

The Commission observes that although the proposed cost model is NGN-based, it allows for the recoupment of some PSTN costs. However the cost model should be based on efficient technologies available in the time frame considered by the model, therefore the core network of a model built today should ideally be NGN-based, to the extent that the costs of

[7] The accompanying Explanatory Note of the Commission Staff Working paper (SEC(2009) 600, 7.5.2009)

such a network can be reliably identified. A hybrid PSTN/NGN model might be suitable to attain the objectives included in Article 8 of the Framework Directive provided that the resulting costs are only traffic-related and that common costs are not being attributed to the recoverable costs of an efficient operator. Given the high proportion of PSTN costs included, in view of the impact on the final results and the prospective replacement of PSTN with IP technology by an efficient operator, the Commission considers that BNetzA could have reduced the share of PSTN related costs on a forward looking basis.

Furthermore, the Commission notes that, although reconciliation exercises can be performed in order to identify the sources of differences, to quantify those differences and to make appropriate adjustments accordingly with a view to assist in the verification of pure BU-LRIC models, BNetzA's approach to reconciliation starts from DT's data. Given the source of the OPEX and the absence of BU-LRIC modelling for OPEX, it is difficult to assess to what extent the proposed adjustments have been sufficient to address DT's potential inefficiencies.

The Commission consequently considers that Articles 8(4) of the Framework Directive and Article 13(2) of the Access Directivehave not been adequately followed.

Due to the lack of analysis on net payments effects, the Commission also considers BNetzA's comparative considerations to the impact of pure BU-LRIC/LRAIC+ on revenues and investment capacity as limited. The Commission also considers that BNetzA's argument of a waterbed effect represents a static viewpoint. Therefore, the Commission does not share BNetzA's view that its proposed method is better suited (than pure BU-LRIC) to serve the policy objectives of promoting competition and protecting EU citizens' interests.

In particular, the Commission considered that the proposed LRAIC+ methodology may lead to competitive distortions between 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 notes that the level of fixed termination rates resulting from BNetzA's proposed approach is higher than the average FTR in Member States which employ a pure BU-LRIC methodology in compliance with the Termination Recommendation and in line with Articles 8 (4) and 13 (2) of the Access Directive.

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 particularly important to ensure that regulators do not favour their national operators at the expense of operators in other Member States by not introducing fully cost-oriented termination rates.

4. ASSESSMENT OF THE SERIOUS DOUBTS

On 8 April 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 BU-LRIC approach as laid down in the Termination Recommendation and not the LRAIC+ (designated under CESP/KeL, 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 Termination Recommendation based on the Article 19 of the Framework Directive. Indeed, starting from the Termination Recommendation would ensure that all arguments developed by the European Commission in favour of a pure BU-LRIC approach are adequately reflected. Based on this starting point, and after analysing both methodological and competition issues to use a LRAIC+ approach rather than a pure BU-LRIC one in order to set fixed termination rates, BEREC shares the serious doubts of the Commission with respect to the choice of the costing approach.

In addition, BEREC notes that nearly **[redacted]** of the termination rate proposed by BNetzA are in excess of the calculated BU-LRAIC+ approach. The amount in excess to LRAIC+ is largely composed of PSTN related costs which are modelled neither on a forward-looking nor under an incremental approach.

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 considering whether justify deviation from the Termination Recommendation. The first concern being *the need to ensure that customers derive maximum benefits in terms of efficient cost based termination rates*. The second concern refers to *the creation of barriers to the internal market.*

4.1. General observations

On its notified draft 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, BNetzA can approve rates on the basis of the CESP (or LRAIC+) according to section 32[8] 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

[8] 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

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 LRAIC+ (cost methodology according to Section 32 (1)) to achieve the policy objectives.

Furthermore, BNetzA explains on its notified draft that, based on section 32 (2)[9] of the TKG, recognition of costs in addition to CESP/KeL (or LRAIC+) is objectively justified and deriving from a legal obligation, in case of costs related to redundancy payments. BNetzA also explains that while there is no legal obligation to maintain PSTN in Germany, recognition of PSTN costs in FTR is objectively justified by the fact that the switch from PSTN to NGN is a deep lying technical change whose implementation requires considerable investments.

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

According to 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 it is recommended by the Commission, within Article 2 and 6 of the above Recommendation, that the cost of efficient service provision for fixed termination rates is the pure BU-LRIC. Therefore under the current EU framework, any NRA which wants to deviate from it has to provide sufficient 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 LRAIC+ (see section 3.8.2.5.3. on page 59 of the notified document[10]), but considers that a proper justification of the choice of LRAIC+ by BNetzA should have consisted in assessing whether LRAIC+ 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.

As far as PSTN and redundancy (Vivento) costs are concerned, BEREC understands their recognition in FTR falls within the margin of discretion of BNetzA.

[9] Expenditure not included in the cost of efficient service provision is taken into account, in addition to subsection (1), only insofar as and as long as such expenditure derives from a legal obligation or the undertaking seeking approval demonstrates other proper justification for it. Where the Bundesnetzagentur, in examining the cost statements, deems essential components of the stated costs inefficient, it shall request the operator, without undue delay, to explain whether and to what extent these costs components constitute expenditure within the meaning of sentence 1.

[10] In the following, we are referring to the document number BK 3d-12/009 (non-confidential version of the draft regulatory order)

4.2. 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 four parts: methodological issues, fixed to fixed competition issues, mobile to fixed competition issues and costing issues.

a. Methodological issues on the LRAIC+ 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?
- Ways to contribute efficiently to a potential recovery gap?

Although not all of these issues are extensively discussed in BNetzA's draft decision on fixed termination rates[11], 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.

Views of BNetzA

After explaining the Commission's pure LRIC approach and the advantages of KeL (LRAIC+ or CESP)[12], BNetzA concludes[13] that: "*In the present case, it cannot be proved due to general economic considerations or with a view to the special features of the termination market that a competitive price for terminations would swing to the LRIC level rather than the KeL level. A LRIC regulation cannot in any case be justified in this manner from the viewpoint of emulating the competitive price.*"

BNetzA's general orientation when setting appropriate prices for the fixed termination service is the simulation of a competitive outcome (the "as-if competition price"), which was the starting point of the discussion on allocative efficiency. In this context BNetzA builds on its experience: *"In der previous regulation practice on termination charges,* the *Deliberating Chamber assumed that the KeL price of termination corresponds to the as-if competition*

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[12] This discussion leads BNetzA to the conclusion: "*It can neither be determined that the recommended LRIC price corresponds better to the competitive price than a KeL price, nor can it be concluded by way of impact assessment that a LRIC price is better suited than a KeL price to prevent undesired capital outflow from other sectors and/or improve competitive behaviour of the fixed network operators in the end-user markets*." (sect. 3.8.5.2.3.1) The next sections will discuss the arguments which lead to this conclusion in more detail.

[13] Remedy draft, section 3.8.5.2.3.1.1

price and its setting prevents competition distortions. This assessment is now questioned by the termination recommendation of the Commission." [14].Further in the discussion of the emulation of a competitive price BNetzA states: *"For this case, the previous considerations imply that the total amounts, obtained from any which customer, should correspond to the coverage of the termination costs of unit costs of an efficient network operator".* Referring to the specifics of the termination service*: With the presence of two direct service recipients, an undertaking, like the subjects, primarily has the option to require a coverage amount for unit costs of the service provided from both sides […] An undertaking will primarily orient itself to the respective price elasticities in case of the how and why of such a distribution"*[15]. However […] *"It cannot just be inferred from the circumstance that unit costs of the termination service could principally be covered from two sides that both sides would actually be taken into account in the case of competition." […] It is basically left to it* [the SMP-operator] *to determine the kind of its economic activity itself and to design its purchase and sales system at its own discretion in such a way that it holds for correct and meaningful, to the extent that it does not use such means in this regard which would violate the freedom of competition."*[16]

BEREC's Assessment

From a static efficiency 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". This analysis draws extensively from what has been stated at BEREC's opinion DE-2013-1424, as, from a methodological point of view, most of these aspects apply for mobile and for fixed termination alike :

- 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. 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, i.e. 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[17] and encounters (under a CPP regime) a call externality, which is not taken into account[18]. Not considering this market failure (the call externality) when regulating FTRs, puts in doubt, whether economic efficiency (and sustainable competition and the aim to maximise consumer benefits) were sufficiently taken into account. To the extent that

[14] Ibid, section 3.8.5.2.3.1
[15] Ibid, section 3.8.5.2.3.1.1.2
[16] Ibid
[17] 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 (e.g. C(P)S) are seeking a one-way access service.
[18] 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.

this market failure was not addressed, the proposed "as if – competition price" cannot be economically efficient.

- Applying the proposed KeL/CESP (LRAIC+) method to the termination service means that the whole cost of the call would be covered by the calling party, while this calling party is also 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 Commission has taken into account this externality when developing the recommended approach. BNetzA does not elaborate on this key argument.

- Concerning BNetzA's view that a CESP approach is better suited to represent the efficient unit costs (sec. 3.8.5.2.3.1.1.3 remedy draft), as cost are allocated in the cost specific manner of co-production, 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[19]. Also, 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/LRAIC+ 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 NL-2012-1284[20]:

- Concerning BNetzA's argument that *"The decisive advantage exists in the source based (verursachungsgerecht) allocation of the costs (pre-service relevant and efficient) of the respective connection services in accordance with the KeL concept of the termination service. In connection with this it should be emphasised that there is no reason to consider services used purely within the network as main services and services sold external to the network in accordance with the version of the decision chamber with the consequence that joint costs should be solely carried by the main services"*[21] 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. source based according to the

[19] 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. However BNetzA's remedy draft document does not differentiate between amongst various groups of operators effected.

[20] BEREC opinion on case NL-2012-1284, page 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)*

[21] Remedy draft, section 3.8.5.2.3.1.1.3

question who is triggering the service), is not sufficient as it does not take into account the specific nature of the termination service.

Based on this reasoning, BEREC notes that it cannot follow BNetzA's reasoning that LRAIC+ (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.

b. Fixed to fixed competition issues

Views of BNetzA

BNetzA's argues[22] that pure LRIC is not better suited then LRAIC+ to control the competitive behaviour of fixed network and that as under the current CESP/KeL regime for FTRs the retail fixed telephony in Germany is already characterised by the extensive presence of flat-rate (lump-sum) offers, a pure LRIC measure would not essentially reinforce this development and that it would not lead to further reducing retail prices, which in BNetzA's view are already low.

BNetzA further states[23] that under a pure LRIC approach, the costs which can no longer be recovered from competitors would need to be recovered from the fixed operator's own customers, so that overall, fixed network customers would be negatively affected. In addition BNetzA considers it cannot predict to what extent customers of smaller alternative networks, or certain categories of customers (business, private, low usage) would be affected following the setting of FTR at pure LRIC levels.

On the other hand BNetzA notes that it cannot reliably estimate the impact of pure LRIC (as opposed to LRAIC+) on the structure of prices or on the volumes of services. According to BNetzA, presently on-net/off-net tariff differentiation is no longer observed in the German market and the flat rates which characterise even the basic offers in the fixed telephony are no longer dependant on the introduction of pure LRIC. However, BNetzA considers that "*The reduction of the termination rate expected in regards (…) of a KeL regulation as well as other connection rates is therefore passed on in the form of cheaper packet prices"*[24]. BNetzA then concludes that reaching lower retail prices through lower wholesale tariffs and subsequently higher usage cannot be fostered any more through a pure LRIC regulation.

The Commission's Concerns

The Commission in its serious doubt letter states that it *''does not agree with BNetzA's assertion that the difference between LRAIC+ based FTRs and pure BU-LRIC based FTRs would lead to an increase of regulated operator's prices for end-users. The Commission considers that BNetzA's argument of a waterbed effect represents a static viewpoint. While cuts in the termination rates may imply price restructuring at retail level, this does not*

[22] Remedy draft, section 3.8.5.2.3.1.2.2
[23] Ibid., section 3.8.5.2.3.1.2.1.3
[24] Ibid.

necessarily translate into higher retail tariffs since FTR cuts also lead to dynamic effects which should also be considered. In particular, aligning all termination fees at an efficient cost level gives incentives to operators to compete for subscribers, e.g. by launching new retail packages thus providing additional revenue opportunities for the fixed operators and ultimately greater product/service choice for its end-users. Therefore, the Commission does not share BNetzA's view that its proposed method is better suited (than BU-LRIC) to serve the policy objectives of promoting competition and protecting EU citizens' interest."

BEREC's Assessment

First of all, BEREC understands that while the current draft measure concerns only the FTRs to be applied by DT, BNetzA considers the application of symmetrical termination rates with respect to all providers.

Building on BNetzA's arguments that on-net/off-net tariff differentiation is no longer observed in the fixed market, as even for the basic offers of alternative operators fixed telephony is frequently offered at lump-sums (flat rates), BEREC has attempted to gather information on the magnitude of the network effect in the fixed networks[25], but there was no information available.

On the other hand however, it is well established in the economic theory that marginal costs directly influence prices. A reduction in fixed termination rates is entirely translated into lower marginal costs of providing an *off-net* call, all else being equal. From a theoretical standpoint, there are no reasons why not to expect a competitive market would respond to lower fixed termination rates by lowering prices for off-net fixed calls. BNetzA failed to support its claims with evidence about the lack of influence of pure LRIC on flat rate competition (compared to current LRAIC+ situation). On the contrary, to the extent that fixed telephony is offered at a lump-sum (flat-rate), whether a reduced FTR would be translated into a more competitive lump-sum price for fixed telephony or for the entire bundle will depend on the fixed markets' competitive dynamics. For example in the presence of lump-sums, a reduced FTR could lead to i) more minutes included in the lump-sum (e.g. for those bundles that are not unlimited); ii) more "unlimited calls" bundles; and/or iii) more competitive prices for "unlimited bundles".

Secondly, lack of on-net/off-net price differentiation in the German market does not mean that in the presence of traffic imbalance to the detriment of smaller or new entrant operators, a reduction in fixed termination rate does not improve their net financial deficit vis-à-vis larger ones. This improvement means that, contrary to BNetzA claims, in the presence of lower FTRs it will be easier for smaller and new entrant operators to cover non-incremental costs, which, importantly for the competitive process, would in turn enhance their capacity to compete despite smaller economies of scale.

BEREC therefore considers that the presence of flat rate or bundled fixed telephony does not in itself mean that consumers can no longer benefit from FTR reductions, or that flat rates *per se* can justify conservative approaches to the regulatory costing of fixed termination.

[25] on-net versus off-net fixed volumes

Thirdly, it is not clear to BEREC why, in BNetzA's view, past reductions in FTRs have been translated into more competitive retail pricing, while a further reduction would reinforce this phenomenon only to the extent it is not purely-LRIC based. In this respect, BEREC has attempted to gather information regarding the potential impact of a pure LRIC relative to a LRAIC+ FTR on the various fixed operators in Germany (integrated fixed-mobile operators, resellers, etc.), as well as on a potential "waterbed" effect on the German consumers (business, low usage, etc.), but there was no information available.

In BEREC's view, whether and to what extent the impact on German operators (of implementing pure BU-LRIC FTRs) are passed on to the retail market would primarily depend on a number of factors related to the competitive conditions in the German fixed voice retail markets, as well as on the magnitude and the distribution of impacts[26]. For instance, leaving aside for a moment dynamic benefits on competition and consumers, if the direct net impact of implementing pure LRIC is positive for a number of operators, it can act as a constraint on other operators to raise prices to consumers.

While the potential for and magnitude of a hypothetical waterbed effect should in principle have been thoroughly investigated when assessing the choice over the relevant increment for FTRs, BEREC notes that not only BNetzA did not analyse the impact of implementing pure BU-LRIC FTRs on fixed operators or on the retail prices in fixed networks, but also that no evidence has been provided neither on the potential existence of a waterbed effect, nor on its potential magnitude. Moreover, considering that i) different fixed operators would likely be impacted differently by the implementation of pure BU-LRIC FTR; ii) some fixed operators would likely be positively impacted; and iii) BEREC's understanding of the intensity of competition in the German retail market, an eventual waterbed effect is likely to be of trivial magnitude if not improbable.

BEREC also agrees with the European Commission that the application of a pure BU-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, on one hand, to increased levels of allocative (static) efficiency in the overall market, 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 an improbable "waterbed effect". The risk that BNetzA mentions – namely 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. BEREC also considers that, contrary to BNetzA assumption that high share of bundled, unlimited retail offerings blocks any price changes, the lowering of termination rates can provide the smaller operators with an improved ability to match and/or offer more innovative retail offers.

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

[26] see for example BEREC opinion on case IT/2013/1415

c. Mobile to fixed competition and circularity issues

Views of BNetzA

BNetzA notes[27] that, in contradiction with the Termination Recommendation, pure LRIC cannot better address the issues of capital outflow from fixed to mobile networks or the desired competition results in the form of cheap and possible lump-sum retail tariffs, as compared with LRAIC+ (CESP/KeL). BNetzA further argues[28] that a pure LRIC regulation of FTR cannot counteract capital outflows into the mobile sector, since MTRs will be LRAIC+ based and under such circumstance the asymmetry between FTRs and MTRs will increase, which in turn would be contrary to the aim of recital 3 in the Termination Recommendation.

The Commission's Concerns

The Commission notes that: *"In addition, BNetzA argues that the use of BU-LRIC for FTRs (instead of LRAIC+) would decrease the level of FTRs thus increasing the FTR-MTR price difference. Moreover, setting FTRs on the basis of BU-LRIC would according to BNetzA reduce the revenues of fixed operators and hamper the investment capacity of the fixed sector. The Commission is of the view that BNetzA's reasoning does not take into consideration the downward impact of BU-LRIC on MTRs, which would lead to a reduction of payments from fixed to mobile operators. BNetzA does not analyse net payments effects based on traffic flows nor does it calculate what the level of BU-LRIC based FTRs would be. Against this background, the Commission considers BNetzA's comparative approach BULRIC/ LRAIC+ as limited.*

BEREC's Assessment

In BEREC's view, there is a circularity in BNetzA's statement, when it argues that the LRAIC+ based MTRs are (amongst other reasons) a barrier to setting FTRs at pure LRIC (or BU-LRIC in the Commission's terms) rate, as otherwise this would result in even increased capital outflows from fixed operators, which in turn would be against the Commission's Recommendation. BEREC notes, that - in its opinion on case DE-2013-1424 - it agreed with the Commissions view, that BNetzA did not provide sufficient evidence that a deviation from the Termination Recommendation would have been justified in case of MTRs. Therefore BEREC shares the Commission's (implicit) view, that an argumentation that refers to LRAIC+ MTR's is entirely unjustified. BEREC accepts in principle that, in a situation with LRAIC+ based MTRs and pure LRIC based FTRs, the competitive distortions between fixed and mobile networks might be further accentuated. However, this issue is of no relevance in itself, as there is in fact no justification to treat mobile and fixed termination rates conceptually differently. This aspect of ensuring technology neutral harmonisation in call termination regulation and a level playing field between fixed and mobile operators is a key motive of the Termination Recommendation.

However, in BERECs view, there are some analytical elements missing in BNetzA's argumentation of the fixed-mobile relation. First, and in support with what the Commission raised in its serious doubts letter, BEREC would have expected that BNetzA had done an

[27] Remedy draft, section 3.8.5.2.3.1.2.1
[28] Ibid., section 3.8.5.2.3.1.2.1.2

analysis on a pure LRIC approach covering both fixed and mobile termination rates. Absence of detailed cost calculations does not make it less evident that the absolute level of fixed-mobile termination rate differential will be lower under pure LRIC than under LRAIC+. Hence – depending on the traffic flows between the networks – the fixed network operators (and in the end their customers) would be better off under pure LRIC. It has already be mentioned under 4.2.b. above that pure LRIC FTRs could facilitate start-up or smaller fixed network operators and thus have a positive impact on the dynamics of competition. But the argument goes further: When fixed network operators are confronted with a higher fixed-mobile termination rate difference because of pure LRIC based FTR (and LRAIC + based MTRs), it is economically rational for the fixed operators to argue in favour of LRAIC+ FTRs.

BEREC also shares the Commissions view that *BNetzA does not analyse net payments effects based on traffic flows* and considers this as a serious shortcoming of the analysis. In BERECs view it is not sufficient to analyse FTRs and MTRs on the level of fixed vs. mobile operators, instead a more detailed assessment on the effects for different groups of operators (integrated fixe-mobile operators, smaller fixed operators, start-ups, mobile operators…) with respect to in/out relations would be required. Although BNetzA did not provide information in this respect (as already shown under 4.2.b. above), only a more detailed analysis on the impact of different groups of operators would allow clear statements about the competitive effects and could provide arguments for a national deviation. A discussion that remains on the overall fixed mobile-level without further (empirical) evidence misses this requirement.

Furthermore, use of LRAIC+ (as opposed to pure LRIC) to set termination rates distorts the level playing field between fixed and mobile operators. Leaving aside for a moment traffic flows and what kind of termination is more costly (mobile or fixed), a larger cost base included in the regulated fixed termination rates means that fixed operators are allowed to recover from regulated termination a significantly higher cost base, at the expense of mobile operators and ultimately mobile consumers. Such an approach also risks underestimating the competitiveness of fixed networks.

Last, given the traffic imbalances between fixed and mobile networks, the comparatively smaller net flows of revenues from fixed operators to mobile operators implied by the use of pure LRIC (instead of LRAIC+), as well as the level playing field introduced by pure LRIC in the regulatory treatment of termination services and the stronger retail competition, BEREC does not see how a pure LRIC approach to FTRs would not, in combination with pure LRIC MTRs, provide more incentives for NGN/NGA investments from the part of fixed operators.

For these reasons above, BEREC also agrees with the European Commission that BNetzA did not provide sufficient evidence that would allow concluding an LRAIC+ would be better suited than a pure LRIC, with regards to competition between fixed and mobile operators and the interests of consumers.

d. Costing PSTN and OPEX issues

BNetzA's views

BNetzA said that adding PSTN expenses is justified by Section 32 (2) of the TKG, the "*important objective* [of which] *is to allow the regulated undertaking to refinance expenditure which may not be a part of the costs of efficient service provisions but are still necessary due to legal requirements or other material reasons*." BNetzA said that a deviation from the regulatory benchmark is deemed acceptable to the extent that it prevents a cost recovery shortfall which cannot be attributed to the undertaking not being sufficiently efficient.

BNetzA considered that, while DT is not legally obliged to maintain its PSTN network, accounting for the costs of PSTN is materially justified on the basis that the switch from PSTN to NGN is a deep-lying technical change and that unlocking the efficiency gains of NGN requires considerable investment in other products with no indication that DT has not implemented these changes. In addition, BNetzA considered that the development in competitor networks also showed evidence that the PSTN technology still meets the principle of path-dependent efficiency, since the number of PSTN connections has only been reduced slightly since 2008. BNetzA also took into account the PSTN expenses on the basis of real payments made by DT, not cost accounting methods; in particular, it considered these expenses were to be determined based on the costs of procurement and production and not on the alternative basis of replacement values.

The Commission's concerns

The Commission observed that the costing methodology presented in BNetzA's draft measure does not appear to comply with the principles and objectives set out in the regulatory framework and, in particular, the importance of ensuring 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 reiterated its view that the core network of a model built today should ideally be NGN based (to the extent that its costs can be reliably identified) and only traffic-related costs should be considered and that common costs are not being attributed to the recoverable costs of an efficient operator. The Commission noted that, although BNetzA's proposed cost model is NGN-based, it included common and other non-traffic related costs elements, but also PSTN costs. It considered that a hybrid PSTN/NGN model might be suitable to attain the objectives included in Article 8 of the Framework Directive provided that only traffic-related costs are considered.

The Commission however noted the proportion of the PSTN costs in the proposed FTR and, in view of its impact on the final result, considered that BNetzA's methodology should have taken into account on a forward-looking basis the transition to NGN (i.e. likely decreasing PSTN and increasing NGN traffic).

The Commission also observed that BNetzA derived OPEX from DT's data (a 'top-down' approach in its view), adjusted for efficiency and stated its preference for a BU approach. It considered that BNetzA's top-down approach should only have been used to reconcile a potential BU approach and that, in the absence of a BU determination, it is difficult to assess to what extent the efficiency adjustments are appropriate.

BEREC's assessment

As we have discussed above, BEREC considers that BNetzA has not provided a valid justification for deviating from the Termination Recommendation. As we have emphasised above, BEREC considers that the starting point for setting FTR should be the Termination Recommendation. In particular, BEREC considers that BNetzA should have considered the impact of setting FTR based on a pure BU-LRIC methodology either first or in conjonction with its current proposal and has not provided any valid evidence in relation to i) the impact of implementing pure BU-LRIC FTRs in Germany; ii) why such impacts whould justify deviating from the termination Recommendation; and iii) how the current proposals would address the issues that justified the deviation. BEREC considers this to be the key issue in the present case.

In this section, BEREC aims to set out why it considers that, *irrespective of whether BNetzA has valid reasons to deviate from the Termination Recommendation*, its current methodology raises a number of other issues. While BEREC does not consider this to be the key issue in the present case, it feels compelled to address it as the Commission has raised serious doubts on specific aspects of the costing methodology. For instance, the Commission expressed the view that the added PSTN costs amount to a significant proportion (**[redacted]**%) of the proposed FTR and also considered that BNetzA should have taken into account on a forward-looking basis the transition to NGN.

BEREC does not consider that, in relation to the technological choice, BNetzA's cost model deviates from the Termination Recomemndation. As BEREC made it clear in its opinion on the recent EC Phase II investigation in relation to AGCOM's proposed FTR[29], NRAs (in that case, AGCOM) might have legitimate reasons to set a glide path with the transition FTRs being based on the costs of the available efficient technologies (PSTN and NGN in that case). The Commission also shared this view in its SDL to BNetzA in the present case, stating that a hybrid PSTN/NGN model might be suitable to attain the objectives included in Article 8 of the Framework Directive provided that the resulting costs are only traffic-related and that common costs are not being attributed to the recoverable costs of an efficient operator.[30]

However, BEREC considers that BNetzA's methodology for setting FTRs also deviate from the Termination Recommendation in a number of other ways for which, on the basis of the information available, it could not find valid justifications.

Firstly, BEREC agrees with the Commission that a hybrid PSTN/NGN model is suitable *only to the extent that it is based on pure BU-LRIC models for both technologies* (i.e. does not include any allocation of common costs or other non-traffic related costs), unless a valid justification has been provided to deviate from this model. As discussed above, BEREC does not consider such justification has been provided by BnetzA (see points i), ii), and iii)

[29] 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
[30] See page 8, second paragraph.

above). BEREC will therefore not analyse in details the inclusion of common costs, rental costs and Vivento/staff reduction costs which it does not consider to be neither incremental to the provision of fixed call termination nor forward-looking.

Secondly, BEREC shares the Commission's view that NGN operating costs should be determined using a BU methodology and considers that such costs can now be reliably identified and have already been modelled using a BU-LRIC model by a number of NRAs. The OPEX figures for the NGN model appear to rely on DT's data both directly (see first paragraph of section 4.1.2.2) but also when calibrating WIK's NGN model (see last paragraph of 4.1.2.2.2). BNetzA does not however consider its approach as 'pure top-down' but, rather, as a very detailed presentation of the various cost components on the basis of which rental and operating costs have been corrected. As such, it considers it similar in detail to a bottom-up approach. BEREC also shares the Commission's view that, in the absence of a BU determination, it is difficult to assess to what extent the efficiency adjustments are appropriate.

Finally, BEREC shares the Commission's view that BNetzA should have taken into account on a forward-looking basis the transition to NGN. BEREC could actually not exclude from the information available to it that BNetzA's current methodology involves double counting (at least at some point during the period covered by the review), and therefore could not exclude that such methodology would in any case lead to FTR 'inefficiency'. This potential double counting might explain why the added PSTN costs, which are made of CAPEX and OPEX (rental and operating expenses), amount to a significant proportion of the proposed FTR (**[redacted]**).

In BNetzA's view, its methodology does not lead to double counting and it argued that the PSTN costs are only added "if, currently, they still exist in the books". Given that the CESP/KeL was determined assuming that 100% of the traffic is NGN, BEREC could not exclude (based on the available information) that any cost from another network technology added to the CESP/KeL without traffic weighting (on a forward-looking basis) does not amount to double counting and therefore is unlikely to be justified unless the *same* terminating traffic makes use of *both* existing technologies (i.e. the PSTN and NGN elements whose costs are included in the FTR) on a forward-looking basis during the period of the charge control. The fact that BNetzA has discarded some CAPEX expenses when determining the PSTN costs does not, in BERECs' views, elliminate the ambiguity regarding a potential double counting.[31]

BEREC considers that a methodology that would determine a weighted average (forward-looking, incremental) cost of the available efficient technologies (e.g., based on the relative amount of traffic expected to terminate on both type of networks) would lead to less inefficient FTRs and would also address the issue of the transition to NGN if the weights are determined on a forward-looking basis. This might involve a glide path in which termination rates are set in each of the years of transition based on the expected weights. Such methodology would address the concerns expressed in the SDL in relation to taking into

[31] BNetzA distributed the above PSTN CAPEX and OPEX costs among the voice services (e.g. termination and origination) based on their network utilisation in the NGN network which, it said, can be calculated using standardised traffic volumes, routing factors, and network elements costs. Therefore, BNetzA assumes that, when determining these costs, the entire (NGN) termination traffic also makes use of the PSTN network.

account the migration of traffic from PSTN to NGN (and therefore decreasing FTR) during the period of the charge control.

4.3. Assessment on *creation of barriers to the internal market*

Views of BNetzA

BNetzA argues[32] that a pure LRIC regulation would not be better suitable to foster the development of the internal market, because such regulation, in the German regulator's view, would not be better capable of meeting the regulatory objectives inscribed in Article 8 of the Framework Directive, particularly those related to competition and consumer protection, than a LRAIC + approach.

BNetzA also notes that the uniform application of a pure LRIC methodology would not lead to identical wholesale tariffs, so that Europe-wide uniform offers would always be subject to a mixed calculation of different wholesale tariffs.

The Commission's concerns

The European Commission argues, in its serious doubts letter, that the application of a LRAIC+ methodology in Germany would lead to considerable differences in absolute terms between German FTRs and those of other Member States which are calculated in accordance with the Termination Recommendation. This difference, the Commission goes on to argue, would be incurred at the expense of the operators, and eventually consumers, in the Member States from where the calls originate.

BEREC's Assessment

BEREC shares Commission's general concern with the impact of widely different termination rates across EU Member States in the promotion of the internal market, and notes that this was one of the main reasons why the Commission adopted a Recommendation on termination rates.

However, BEREC also notes, as it has been consistently stated in past phase II opinions[33], that it is not the variation of (mobile and fixed) termination rates within the EU, *per se*, that create barriers to the internal market, but the unjustified national deviation from a common methodology put forward by the Termination Recommendation. The cost model prescribed in this Recommendation accommodates national specificities, as it aims at calculating the incremental cost of an efficient operator providing services in a particular member state. For this reason, the application of this methodology could in any case result in different termination rates being enforced within the EU. Therefore, absolute levels of termination rates across EU Member States should not be a concern regarding the creation of barriers to the internal market, when the same tariff is charged to national and cross border operators and provided also that the recommended methodology is used.

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[32] Remedy draft, section 3.8.5.2.3.1.4
[33] For instance, cases CZ/2012/1392, IT/2013/1415 and DE/2013/1424

The analysis conducted in the previous sections has shown that, in BEREC's view, BNetzA's decision to deviate from the Termination Recommendation is not justified. Therefore, BNetzA's decision to deviate from a common, Europe-wide methodology would result in a barrier to the internal market, putting the operators and ultimately the consumers in other Member States that apply a pure LRIC methodology at an undue disadvantage. It is of note that, according to BNetzA's response to the questions asked by the EWG, in 2012 around 13.7 billion minutes originated abroad would have been terminated by German fixed networks[34]. This is a significant figure and its order of magnitude is of around 42% of the overall mobile-fixed traffic in Germany. The peak rate proposed by BNetzA to apply from December 2012 to December 2014 is higher than in any country that has applied a pure LRIC methodology, and stands 230% higher than the average of such countries[35]. The off-peak rate stands at around 129% higher than the average. Although BNetzA says that international traffic is likely to be balanced, this says nothing about specific operators in some Member States, which may suffer a net loss resulting from the application of a LRAIC + methodology in Germany. Clients of these operators could be put at a disadvantage with this regard, should their operators choose to "overcharge" them as a result of facing higher marginal costs for providing international fixed calls to Germany. This, according to standard microeconomic theory, is highly likely to happen.

In addition, BEREC reaffirms for fixed termination rates what has been stated regarding the case DE/2013/1424, namely that "*higher wholesale charges can present potential side-effects of distorting consumer behavior and amplifying the deficits in the international traffic balance of German mobile operators. 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).*"

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

5. CONCLUSIONS

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 FTRs are not based on a pure BU-LRIC costing methodology, as recommended by the Commission based on the economic analysis that shows that pure BU-LRIC results in a better competitive outcome, and (ii) BNetzA has not provided valid justifications for deviating from the Termination Recommendation. In particular, BNetzA has neither proved that the potential

[34] BNetzA has no figures for minutes originated outside Germany and terminated in fixed networks, but it states nevertheless that it is likely that there is an approximate reciprocity to the variable "minutes originated in fixed networks terminated outside Germany" which, in 2012, amount of the quoted figure.

[35] All countries in the Benchmark (DK, FR, IE, MT, BG), except Denmark, have a unique rate regarding peak and off-peak periods. Danish rate distinguishes peak and off-peak periods and has a call set up. For the purpose of this text, the Danish rate corresponds to the average rate per minute for a call that lasts 3 minutes, and if 50% of the traffic would be peak/off-peak.

impacts of applying pure BU-LRIC based tariffs on German operators and/or consumers would justify a departure from pure BU-LRIC, nor has it proved that it's proposal 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 FTR costing methodology.

In addition, BEREC shares the Commission's concerns that BNetzA's proposal could create barriers to the internal market if other NRAs set FTRs based on the methodology recommended by the Commission (via a bottom-up model or by benchmarking) while BNetzA deviates from that methodology without valid justification.

In the light of the Commission's serious doubts and the argumentation above, BEREC recommends BNetzA to set the fixed termination tariffs for Deutsche Telekom AG at the level of pure BU-LRIC costs, without any glide path[36].

[36] An eventual glide-path driven by the transition to NGN might in certain circumstances be justified, as long as it is captured under a pure BU-LRIC costing methodology.