BoR (13) 97

BEREC Opinion on

Phase II investigation

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

Cases AT/2013/1475-1476

Wholesale (physical) network infrastructure access and wholesale broadband access (markets 4 and 5) in Austria

5 September 2013

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1. EXECUTIVE SUMMARY

On 25 June 2013, the European Commission registered a notification by the Austrian Regulatory Authority, Telekom-Control-Kommission (TKK), concerning the markets for (physical) network infrastructure access and wholesale broadband access in Austria (corresponding to markets 4 and 5 in the Commission Recommendation 2007/879/EC of 17 December 2007).

In the notified decisions TKK has proposed price control in market 4 to be based on cost orientation (FL-LRAIC) and margin squeeze tests. The price for full unbundled local loop has been set at a current margin squeeze free level of €5.87. In market 5 TKK has proposed price control based on retail minus related to margin squeeze results.

On 25 July 2013 the Commission sent a serious doubts letter opening a phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC. The Commission's doubts concern the lack of sufficient evidence supporting the use of margin squeeze test instead of cost orientation as a price setting mechanism in Austrian markets 4 and 5. The Commission believes that the application of the margin squeeze test as proposed by TKK is likely to prevent the establishment and development of a trans-European network, thus creating barriers to the single market. The Commission has serious doubts as to the compatibility of the price control remedies proposed by TKK with EU law and consider that this remedy creates barriers to the internal market on both infrastructure access and wholesale broadband access markets. The Commission, however, did not comment on the resulting violation of the non-discrimination principle if a strict cost orientation in the Austrian markets 4 and 5 was applied.

On the basis of the economic analysis set out in this Opinion, BEREC considers that the Commission's serious doubts are not justified.

2. INTRODUCTION

On 25 June 2013, the European Commission registered a notification by the Austrian Regulatory Authority, Telekom-Control-Kommission (TKK), concerning markets for (physical) network infrastructure access and wholesale broadband access in Austria (corresponding to markets 4 and 5 in Commission Recommendation 2007/879/EC of 17 December 2007). On 5 July 2013, a request for information (RFI) was sent to TKK, and a response was received on 10 July 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 being issued on 25 July 2013. In accordance with the BEREC rules of procedure, the Expert Working Group (EWG) was established immediately thereafter with a mandate to prepare an independent BEREC opinion on the justification of the Commission's serious doubts on the case.

On 5 August 2013 the EWG sent a first list of questions to TKK. Answers were received from TKK on 5 August 2013. The EWG met on 6 August 2013 in Warsaw. During that meeting the

EWG held an audition with TKK to gather further information and clarification in response to the questions sent the previous week. In addition, some further questions were also raised by the EWG. A second list of questions was sent to TKK on 9 August 2013 and further answers were received on 12 August 2013. The objective of the EWG was to reach clear conclusions on whether or not the Commission's serious doubts are justified.

A draft opinion was finalised on 29 August 2013 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 5 September 2013. This opinion is now issued by BEREC in accordance with Article 7a(3) of the Framework Directive.

3. BACKGROUND

Previous notifications

Market 4

The definition of the market for wholesale (physical) network infrastructure access in Austria was previously notified to and assessed by the Commission under case AT/2008/0835. The SMP analysis and remedies were notified under case AT/2010/1084, where TKK designated Telekom Austria with SMP and imposed, inter alia; (i) access to LLU and SLU including colocation; (ii) access to ducts, and subsidiary dark fibre as backhaul service; (iii) access to virtually unbundled local loops; (iv) reference offer and; (v) price control according to retail-minus with a maximum cap based on a FL-LRAIC model.

Market 5

The market for wholesale broadband access in Austria was previously notified to and assessed by the Commission under case AT/2009/0970. The Commission expressed serious doubts as to: (i) the lack of evidence for inclusion of mobile broadband in the retail market for residential customers and; (ii) the market definition at wholesale level only being based on the products offered at retail level. TKK amended its draft measure which led to Commission's withdrawal of serious doubts. The market analysis and remedies were subsequently notified under case AT/2010/1136. A1 Telekom Austria (A1TA) was found to have SMP and TKK imposed the following remedies: (i) access to ADSL and SDSL bitstream products; (ii) simultaneous provision of a corresponding wholesale product in the case the replication of a newly introduced retail product is objectively impossible without such a wholesale offer; (iii) non-discrimination including the obligation to announce changes to wholesale or retail products at least four weeks in advance: (iv) publication of a reference offer; (v) price control based on retail minus and; (vi) accounting separation.

Current notification and the Commission’s serious doubts

Market 4

The notified draft measures concern the fourth round of analysis of the market for wholesale (physical) network infrastructure. The market consists of copper and fibre infrastructures (unlike previously, FTTH has now been included), sub-loop unbundling, as well as virtual access over copper and fibre (sub-) loops. Self-supply has been included in the relevant market. The relevant geographical market is a national one.

A1TA is found to have SMP. The market share of A1TA is relatively constant between 99.1-99.3%. For the time period covered by the market review, considerable FTTH expansion is expected only from A1TA and thus the market share is not expected to decrease significantly in the coming three years. Further, A1TA is the sole provider for approximately 95% of the households and business and thus has control over infrastructure that is not easily replaceable. The existence of high and lasting market barriers and the lack of countervailing buying power further underline the market power of A1TA.

The draft measure contains the following remedies: (i) access to unbundled subscriber loops and unbundled optical fibre lines for FTTH and colocation; (ii) backhaul services in the form of access to ducts, dark fibre and leased lines/Ethernet; (iii) virtual unbundling as a substitute for physical unbundling, where this is not possible; (iv) obligations relating to information, planning and migration in relation to NGA deployment; (v) non-discrimination including reference offer, SLAs/SLGs/KPIs and proof of technical replicability; (vi) price control based on a FL-LRAIC model in combination with a margin squeeze test; (vii) transparency and (viii) accounting separation.

Regarding the price control obligation, the proposed margin squeeze free regulated LLU price is €5.87, whereas the tariff according to the FL-LRAIC cost model is around €15.34. The increase in the tariff in relation to the last review (cost-oriented tariff was €14.97), as well as the divergence between the cost-oriented price and the margin squeeze free price is explained by increases in the construction price index and copper prices, as well as the decline in the number of subscribers. TKK uses a FL-LRAIC cost model, which is a bottom-up model used to determine the investment values for the network and the access network is valued at replacement costs, depreciated by linear depreciation. Operating costs and capital interest are taken into account separately.

Regarding the margin squeeze test applied by TKK, an equally efficient operator approach is used for all products except the DSLAM management of virtual unbundling, where it is considered more justified to apply a reasonably efficient operator approach. A combined test is used, which first checks that all costs are covered for all broadband products over the period of one year. Moreover, regarding certain products the test makes sure that at least the avoidable costs are covered.

Market 5

The notified draft measures also concern the fourth review of the wholesale broadband access market in Austria. TKK continues to delineate the retail market for residential and business customers, and includes in the residential retail market the following infrastructures: DSL, cable, optical fibre/FTTH and mobile broadband. The retail market for business connections, on the other hand, covers only xDSL and optical fibre/FTTH. Cable is not included, even though some cable operators offer broadband connections to business customers. At wholesale level, the business market includes all internally and externally provided bitstream connections over DSL and fibre that are sold at retail level as business products. The relevant geographical market is a national one.

A1TA is found to have SMP on the business market only with a market share of about 75%. Moreover, as A1TA is the sole supplier for about 30% of the business customers, this also indicates that A1TA has control over infrastructure not easily duplicated. Further on, access seekers do not have sufficiently high countervailing buying power and, although access barriers in the market are lowered by market 4 regulation, the conclusion with respect to the existence of market power remains unaffected.

The following remedies are proposed: (i) access with regional and national handover; (ii) notification of new products and prices; (iii) backhaul; (iv) traffic transport and different traffic classes for the provision of VoB; (v) retail-minus price control; (vi) non-discrimination including a reference offer; (vii) obligations for switching and migration; (viii) transparency and KPIs; and (ix) accounting separation. In order to enforce the price regulation based on retail-minus, TKK applies a margin squeeze test.

Serious doubts

The Commission expressed serious doubts regarding the remedies on the market 4 and market 5 in Austria for the following principal reason:

Lack of sufficient evidence supporting the choice of price regulation

Compliance with Articles 8(4) and 13(1) and (2) of the Access Directive in conjunction with Article 8 of the Framework Directive and Article 16(4) of the Framework Directive

4. ASSESSMENT OF THE SERIOUS DOUBTS

Commission's serious doubts

On 25 July 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 serious doubts concern the compliance with Articles 8(4) and 13(1) and (2) of the Access Directive in conjunction with Article 8 of the Framework Directive and Article 16(4) of the Framework Directive, in particular:

Serious doubts regarding the lack of sufficient evidence supporting the choice of price regulation.

The Commission refers to Articles 8(4) and 13(1) and (2) of the Access Directive, 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, ii) to encourage investments by the operator, including in next generation networks, and (iii) to ensure that the chosen cost recovery mechanism serves to promote efficiency and sustainable competition and maximises consumer benefits.

Furthermore, the Commission refers to Article 8(3)(a) of the Framework Directive, according to which national regulatory authorities shall contribute to the development of the internal market by inter alia removing remaining obstacles to the provision of electronic communications networks, associated facilities and services and electronic communications services at European level. Article 8(3)(b) specifies that NRAs shall contribute to encouraging the establishment and development of trans-European networks and the interoperability of pan-European services, and end-to-end connectivity. Lastly, the Commission refers to Article 16(4) of the Framework Directive, which requires NRAs to impose on SMP undertakings appropriate regulatory obligations.

The Commission takes note of TKK's explanation that the regulatory approach taken by TKK was driven by the particular circumstances in the Austrian market, where the average end customer prices of A1TA are below the average costs. However, while the Commission recognises that the NRAs have a margin of discretion to propose a costing methodology to regulate access rates, the Commission points out that any methodology has to be duly justified in order to show that it fully complies with the policy objectives and regulatory principles of the Regulatory Framework, in particular Article 8 of the Framework Directive.

The Commission has serious doubts that the proposed choice of price regulation based on LRAIC combined with a margin squeeze test in market 4, and by only applying the margin squeeze test in market 5, complies with these regulatory principles.

Market 4

The Commission has the view that even though relatively low access prices may benefit competition and broadband take-up in the short term, allowing access seekers to offer attractively priced products on the retail market, low copper access prices resulting from a margin squeeze test have important shortcomings since they do not send the appropriate build-or-buy signals. In the Commission's view, buying wholesale infrastructure or broadband access at rates, which are much lower than the cost of rolling out the relevant infrastructure, makes investments into parallel infrastructure economically unviable.

The Commission fears that very low access prices are also likely to impede the SMP operator's efficient investment and innovation in new and enhanced infrastructures and create obstacles, rather than removing them, to the provision of electronic communications services. While intense price competition may promote broadband take-up in the short term, consumer benefit in the longer term is likely to be created by new and innovative services provided over NGA infrastructures. In the extreme, copper access prices may be too low to compensate the SMP operator for the maintenance of the network infrastructure already today, and to provide sufficient incentives to offer copper wholesale access products.

In the Commission’s opinion, TKK's current regulatory approach appears not to be consistent with Article 8(5)d of the Framework Directive, which requires the NRAs to promote efficient investment and innovation in new and enhanced infrastructures.

The Commission notes that in market 4 TKK has a fall-back option, which is a cost-oriented FL-LRAIC model, currently providing a "safety cap" of €15.34, which TKK does not foresee to be implemented during the period covered by the notification. A forward-looking bottom-up model is in principle able to send the correct build-or-buy signals and provide the market with the stability and predictability needed in terms of copper access prices. However, the

Austrian model provides a cost-oriented price, which is increased and very high, both in relation to the margin squeeze free price and to the EU average LLU price. Even though the Commission recognizes that there are country specific circumstances, which may affect the outcome of a FL-LRAIC model, the Austrian model, according to the Commission, lacks some features, which would result in a stable, predictable and correct cost-oriented price for the copper LLU. In the Commission's view, these features are the following:

a) gradual shift from a copper to an NGA network;

b) re-usable civil engineering assets would not be replicated in the competitive process; and

c) OPEX should be added in the model as opposed to a mark-up approach in TKK model.

In a situation where a wholesale price resulting from a cost model amended in accordance with the above described would still not allow a sufficient margin for access seekers, the Commission invites TKK to consider whether the competitive situation in certain geographic areas may provide sufficient competitive safeguards, stemming from in particular mobile and cable networks, to prevent the SMP operator from setting excessively high wholesale prices. In such scenarios, price control may not be the appropriate remedy and the Commission invites TKK to consider an alternative regulatory approach.

Market 5

In market 5 TKK proposes to follow an approach similar to that in market 4 and to impose prices based on retail-minus, albeit without the "safety cap" coming from a cost-oriented model. In the Commission's view, regulation of wholesale access prices should be consistent across the value chain. Applying a margin squeeze test, which potentially results in relatively low prices in market 5 while at the same time setting cost-oriented prices in market 4, would therefore not ensure consistency and may be detrimental to promoting investment by alternative operators. Such approach would suppress investment incentives leading to alternative operators buying relatively cheaper bitstream instead of unbundling products and investing in their own infrastructure. Furthermore, wholesale bitstream access prices set below the cost-oriented level can hinder investments and fail to provide the correct build or buy signals.

As requested in point 35 of the NGA Recommendation, NRAs should in principle impose cost-orientation on wholesale broadband access products. The Commission, however, notes that TKK, in its notified draft measure, points to recital 37 of the NGA Recommendation, which concerns situations where an NRA may refrain from imposing cost-orientation and concludes that a retail minus-approach is more appropriate. However, the recital states that a retail-minus price control could be used where sufficient competitive constraints exist on the downstream retail arm of the SMP operator. In the Austrian context, where only the business segment of market 5 is regulated, the Commission doubts that such competitive constraints at retail level exist, due to the fact that business broadband services are not provided over mobile networks and, only to a limited extent, on the cable networks. Therefore, the Commission believes that cost-orientation, at least for copper access products is the appropriate regulatory tool, based on a cost model that fulfils the criteria set out above.

Considering both markets 4 and 5, taking into account the likely negative impact of the margin squeeze test as proposed by TKK on investments of alternative operators and their ability to compete, as well as on the investments made by the incumbent operator, the

Commission concludes that TKK has not sufficiently proved that the proposed price regulation fulfils the requirements of Articles 8(4) and 13(1) and (2) of the Access Directive, read in conjunction with Articles 8 and 16(4) of the Framework Directive and therefore raises serious doubts as to the compatibility of the proposed draft measure with EU law.

Moreover, the Commission emphasised that it currently is finalizing a Recommendation that sets out the regulatory principles to enhance the broadband investment environment. This Recommendation will provide guidance on situations, where an ex ante price control obligation for NGA infrastructure would not be necessary. The Commission invited TKK to review its regulatory approach in markets 4 and 5 once the Recommendation is adopted.

Creation of barriers to the internal market

The above outlined negative effects on investment and sustainable competition of TKK's proposed approach could at the same time have a significant detrimental effect on the development of the internal market. The Commission believes that the application of the margin squeeze test as proposed by TKK is likely to prevent the establishment and development of a trans-European network, thus creating barriers to the single market. Specifically, multi-national operators intending to invest in the Austrian network infrastructure access and broadband markets are likely to be deterred by the limited investment returns in light of the applied wholesale and prospective retail rates.

Therefore, the Commission has serious doubts as to the compatibility of the price control remedies proposed by TKK with EU law and consider that this remedy creates barriers to the internal market on both infrastructure access and wholesale broadband access markets.

BEREC's Assessment - introductory remarks

Before assessing the concerns raised by the Commission in its letter, BEREC finds it necessary to make a remark that is relevant for this case.

BEREC notes that NRAs need to take into account the objectives set in Article 8 of the Framework Directive. The Access Directive gives NRAs discretion when deciding how best to apply the available regulatory tools in the pursuit of these objectives. In the opinion of BEREC, it is therefore important to determine for each individual case, which remedy has to be imposed and how it should be implemented, taking into consideration the specific national circumstances and ensuring that the imposed remedies are proportionate to the identified problem.[1] Therefore, the decision on the type of pricing methodology to be implemented lies fully within the authority of an NRA, as long as it complies with the regulatory framework.

In its serious doubts letter to TKK, the Commission recognizes that NRAs have a margin of discretion in proposing a costing methodology to regulate access rates. The Commission also underlines that any methodology has to be duly justified in order to show that it fully complies with the policy objectives and regulatory principles of the regulatory Framework, in particular Article 8 of the Framework Directive. BEREC fully agrees with the Commission and is of the view that TKK may choose to deviate from strict cost-orientation, as long as TKK can properly justify its choice.

[1] E.g. BEREC opinion Art 7a Phase II Case LV/2012/1296 (BoR(12)28)

In this case, the Commission's serious doubts concern the lack of sufficient evidence supporting TKK´s choice of price regulation. Therefore, BEREC has assessed whether the evidence presented in TKK's draft measure notified to the Commission, as well as its response to the RFI, are sufficient to justify its choice.

Market 4 – Price regulation and build-or-buy signals

Concerns of the Commission

The Commission´s main concern is based on assumption that low copper access prices resulting from a margin squeeze test do not send the appropriate build-or-buy signals, and are likely to impede the SMP operator's efficient investment and innovation in new and enhanced infrastructures. Hence, in the Commission's opinion, TKK's regulatory approach appears not to be consistent with Article 8(5)d of the Framework Directive, which requires the NRAs to promote efficient investment and innovation in new and enhanced infrastructures.

TKK's argumentation

In section 5.3.2 of the SMP-decision, TKK concludes that the problem of over-pricing in the wholesale market can be prevented by using cost-oriented access prices. In the case of unregulated end-user prices it cannot be prevented that the competitors on the downstream level are exposed to a margin squeeze through price discrimination at the wholesale level. Thus cost orientation is a necessary, but inadequate condition. If prices in the end-user market are set below the full costs, like in an unregulated broadband market, then it may lead to a margin squeeze even with cost-oriented wholesale prices. Regular margin squeeze tests in the current market are a necessary measure to prevent exercising of market squeeze.

In section 7.2.5.1, TKK also refers to legal practice[2] and argues that the legal basis of competition law prohibits price policy, which develops a displacement effect for an equally efficient operator.

In its response to the Commission's request for information (RFI), TKK further expands on the matter of build-or-buy signals: the end-customer price, and thus the cost coverage, is primarily determined by the competition with other infrastructures (namely the mobile and cable networks). As the build-or-buy decision in this case is primarily determined by the end-customer price or competition with other infrastructures (and not through the costs of a hypothetically efficient operator), it is the opinion of the TKK that a margin squeeze-free fee for the wholesale price, sets the correct build-or-buy signals in the market. This is specific to the situation in Austria, where the average end customer prices of the incumbent are below the average costs.[3]

In the opinion of the TKK, the existing approach provides efficient build-or-buy signals as an operator who lays its own infrastructure can on average not achieve higher end-customer prices than the incumbent's. Therefore an alternative operator can only have a "build" incentive if its average costs are lower than €5.87.

[2] ECJ, C-52/09, Telia Sonera, Paragraph 39
[3] M4 RFI response question 5 a

BEREC´s Assessment

BEREC generally shares the view of the Commission, that in certain market situations a price regulation focusing on creating an efficient build-or-buy signal is best suited to achieve the aims of the Framework Directive, and ensures appropriate incentives for infrastructure investment. In its report BoR (11) 65, BEREC showed, that an undistorted build-or-buy signal is best achieved by implementation of a CCA/LRIC based cost calculation methodology. However, BEREC also identified some market situations, where other methods of cost-orientation (or price regulation in general), may be more appropriate. The decision on the type of price control to implement is therefore to be determined by individual NRAs in relation to specific competition problems and national circumstances.

In BEREC´s view, a cost-oriented price based on a scorched node[4] FL-LRAIC-model, will in principle give the correct build-or-buy signal to an alternative operator intending to build an efficient alternative to the incumbent's network. TKK has, however, made it convincingly clear that in Austria, the incumbent's main competitors on the retail market are using cable or mobile networks, which at the current state of retail supply and demand are able to provide services more efficiently than a replica of the incumbent's network would. Hence, in BEREC's opinion TKK has provided sufficient evidence that at present, investing in a network replicating the incumbent's, would not be efficient in Austria, and thus an FL-LRAIC-based price regulation would accordingly not induce investment. This seems true regardless of whether the features proposed by the Commission in its Serious Doubts letter are implemented in the FL-LRAIC-model or not.

TKK has explained that by choosing a price regulation method based on margin squeeze, it is ensuring that:

a) the incumbent itself is allowed to compete with the cable and mobile operators at retail level;

b) alternative operators making use of wholesale access can replicate the incumbent's offer, whilst at the same time being able to compete with the cable and mobile operators at retail level;

c) A1TA is able to set its own retail prices (and indirectly setting the wholesale access price) without engaging in unfair pricing strategies.

In addition, TKK has explained that the price emanating from the FL-LRAIC-model will act as a 'safety-cap' to avoid any unlikely price hikes, which would have a negative effect on consumer prices in the short term.

In BEREC's opinion, TKK has provided sufficient reasons in its notification and responses to the RFI to show that the wholesale price based on a margin squeeze test is a more suitable alternative than cost orientation in this specific case.

BEREC has also considered whether there is any particular issue arising from the fact that A1TA is not recovering the FL-LRAIC cost calculated from the model through the margin squeeze free price, and if such a strategy would ultimately lead to less investment and infrastructure based competition. In its response to Question 5 of the RFI, TKK explains that due to the competition from alternative infrastructures, which are more efficient than the

[4] M4 RFI response question 5 b

incumbent, A1TA is suffering from overcapacity over the copper network. Therefore only the marginal cost can be efficiently recovered through the margin squeeze free price. Given that most of the costs of the copper network are of a fixed nature and therefore sunk, and in A1TA's case to a large extent fully depreciated, the recovery of the calculated FL-LRAIC average cost becomes of secondary importance in relation to the competition from alternative infrastructures. Whilst A1TA is not recovering the modeled costs, it does not mean that in reality the incumbent is not making a profit, which would ultimately enable it to invest in new infrastructure. On the contrary, by absorbing these costs A1TA is able to maintain its presence in the retail market until it deploys new efficient infrastructure that would mimic the cost of alternative networks. Taking into account Austrian specific circumstances, BEREC believes that the application of a price control method based on margin squeeze test is actually sending a strong 'build' signal to A1TA if it wishes to be capable to compete with alternative infrastructures.

BEREC also notes that the present price regulation based on margin squeeze test has been in use since 2007. According to the notified draft SMP-decision[5], starting in 2009 the incumbent has made significant investments in FTTC-, FTTB- and FTTH-based NGA infrastructure. The cable network-operators competing on the retail market have invested in DOCSIS 3.0, and are able to provide 100 Mbit/s to 50 percent of the Austrian households.[6] According to the SMP-decision, most of the alternative FTTH providers have only small rollout areas and hold rather lower market shares within these areas. However, relatively high costs of FTTH deployment in Austria incentivize building of alternative infrastructures such as broadband cable and mobile access, which are broadly rolled out in the Austrian market. Hence, the price regulation methodology used by TKK during the last six years does not seem to have had a negative impact on NGA investment incentives and sends the right build or buy signals for both copper and fiber. The Commission's concerns, with regards to negative investment incentives, predictability and stability of wholesale access prices emanating from this choice of pricing methodology, therefore seem not to be based on factual developments in the Austrian broadband market.

Finally, the Commission itself allows for a possibility that its requirements for amending the model might still not allow a sufficient margin for access seekers and invites TKK to consider whether the competitive situation in certain geographical areas may provide sufficient competitive safeguards, stemming from in particular mobile and cable networks, to prevent the SMP operator from setting excessively high wholesale prices. The Commission states that in such scenarios, price control may not be the appropriate remedy and invites TKK to consider an alternative regulatory approach. BEREC would like to stress that this was exactly what TKK did with its proposed measures, namely chose an alternative regulatory approach based on ex ante margin squeeze prohibition, coupled with a safety cap based on cost-oriented FL-LRAIC model and strong non-discrimination obligations[7] to safeguard competition. TKK found that the specific market situation in Austria (i.e. very strong retail price constraints by mobile and cable on a national scale) warrants an alternative non-

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[5] M4, pp. 34/35

[6] M4, pp 33 and 39

[7] See TKK draft decision (unofficial translation), p. 120: "By the imposed equality commitments in relation to the technical and economic replicability, and Service Level Agreements (SLAs), penalties (service level guaranties; SLG), KPIs, and the advance notice period is ensured that at the same time alternative operators can provide retail products at the same prices and with the same degree of quality as A1."

geographically segmented approach to price regulation and BEREC is convinced that TKK provided sufficient evidence to support its reasoning.

In BEREC´s opinion, TKK has presented sufficient evidence during the notification process to justify its choice of price regulation method on market 4. BEREC therefore considers the Commission's serious doubts regarding the lack of sufficient evidence supporting TKK´s choice of price regulation on market 4 not justified.

Market 5 – Price regulation

Concerns of the Commission

The EC has doubts that the competitive pressure in the business segment is strong enough to impose sufficient pricing constraints on A1 Telekom Austria at the downstream retail arm. It therefore believes that cost-orientation, at least for copper access products would be the appropriate regulatory response instead of retail minus.

The Commission points to the fact that business broadband services are not provided over mobile networks and, only to a limited extent, on the cable networks.

TKK's argumentation

TKK points to the following elements that have been taken into account in the analysis:

- LLU operators with higher margin cause price pressure
- price pressure from cable-based products
- price pressure from residential products on low-end business products
- bitstream is not the last step on the ladder of investment. A reduction of the bitstream price would reduce the incentive to migrate to LLU.

TKK is therefore of the opinion that a retail-minus (margin squeeze free) bitstream price is an effective and proportionate pricing remedy.

BEREC's assessment

BEREC generally shares the view of the Commission, that NRAs should in principle impose cost-orientation on wholesale broadband access products in accordance with point 35 of the NGA Recommendation and that in accordance with recital 37 of the same Recommendation; sufficient competitive constraints on the downstream retail arm of the SMP operator are necessary before another price control mechanism (e.g. retail minus) can be justified.

However, TKK has explained that there are enough competitive constraints present on market 5 to allow a retail minus approach:

- In section 2.2.8.3 of the SMP-decision, TKK states that there is competitive pressure from the unbundlers on one hand and even cable network operators exercise a certain price-disciplining pressure on the other (ON 4, p. 105/16). Additionally, BEREC points out to an alternative bitstream offer from operator ASCUS based on its LLU footprint, causing further competitive pressure with its WBA services.

- TKK has provided an analysis of the retail prices for 75 DSL business subscriptions of the 4 largest operators (document ON04 that was presented to EC during the pre-notification meeting). This analysis showed that the prices of A1 Telekom Austria are somewhat above those of their competitors, but the extent is either relatively small (up to 10%) or can be explained by differences in product characteristics. Therefore, there seems to be a competitive pressure on retail price from LLU operators.
- As mentioned by TKK in its response to the market 5 Request for information (RFI), Question 15 and on page 15 of the draft decision, there is also some pricing pressure from cable-based products with a market share around 7%. Although this pressure is not strong enough to include these products in the market based on the hypothetical monopolist test (5-10% price increase), it is likely to become effective in case of a larger price increase.
- In addition, the low price of residential products has a large competitive impact on low end business products which are used on a considerable scale by small firms (around 30%). Even though residential products were considered not to be substitutable by business products (RFI concerning M5, question 13a), the large market share suggests a pricing pressure from the residential market.

Hence, apart from the information provided by TKK in the SMP decision, there are additional elements of proof that point to competitive price constraints that justify the use of a retail minus approach in market 5. In BEREC's opinion, TKK has provided these justifications throughout the notification process following the specific issues raised by the Commission. Consequently, BEREC invites TKK to include in its final decision all these justifications and any other arguments that may further justify its choice of price control method in this market.

Furthermore, BEREC also notes that in relation to market 5, the main concern expressed by the Commission in its serious doubts letter is that the price based on retail-minus will be too low and thus hinder investments and not provide the correct build or buy signals. As noted above, the Commission then expresses doubts that the competitive pressure in the business segment is strong enough to warrant deviating from cost orientation and setting retail-minus prices.

As shown above, BEREC believes that such competitive pressure and price constraints actually exist on the Austrian market. In addition to that, BEREC would like to point out an apparent inconsistency in Commission's reasoning. On one hand the Commission states that the competitive constraints on the downstream retail arm of the A1TA are not strong enough to warrant setting the prices using a retail-minus methodology, which would mean that as A1TA could (because of the absence of competitive price constraints) set excessive retail prices (which is not the case according to retail price analysis provided by TKK), wholesale prices based on retail-minus would also be too high. However, as explained above, the Commission raises concerns not in regard to <u>excessive</u> wholesale price, but to <u>insufficiently</u> high wholesale prices.

Based on this, BEREC is of the opinion that TKK has presented enough evidence during the notification process to justify its choice of price regulation method on market 5. BEREC therefore considers the Commission's serious doubts regarding the lack of sufficient evidence supporting TKK´s choice of price regulation on market 5, not justified.

Consistency between the price regulation of market 4 and market 5

Concerns of the Commission

The Commission considers that the price regulation between market 4 and market 5 is inconsistent, as it presumes that on market 4, prices should be cost-oriented. In such a case, the regulated prices resulting from the margin squeeze test on market 5 would be too low compared to the cost-oriented prices on market 4, which would lead alternative operators to buy the cheaper bitstream access and leaving out the unbundling products and thus having a negative impact on investment.

BEREC´s Assessment

BEREC agrees with the Commission that the wholesale access prices should be consistent across the value chain. However, BEREC is of the view that this consistency is given in the present case. Indeed, both regulated prices in market 4 and 5 result from the application of a margin squeeze test based on retail minus.

BEREC does not agree with the Commission's conclusion of having identified an inconsistency of the price regulation on market 5, while assuming that prices on market 4 are cost-orientated. This does not correspond to the price regulation actually in place on market 4. In addition, as already stated above, in BEREC's view, the Commission does understand that there is a substantial likelihood that cost-orientation does not effectively address the issue of particularly low margin squeeze free prices of LLU in Austria.

LRAIC model

Concerns of the Commission

The Commission recognizes that there can be country specific circumstances, which may affect the outcome of a FL-LRAIC model. Nevertheless, Commission points out that the Austrian model lacks some features, which would result in a stable predictable and correct cost-oriented price for the copper LLU. In the Commission's view, these features are the following:

a) gradual shift from a copper to an NGA network;

b) re-usable civil engineering assets would not be replicated in the competitive process; and

c) OPEX should be added in the model as opposed to a mark-up approach in TKK model.

The Commission also observes that even if the above features would be applied to the model, there is a substantial likelihood that the resulting prices do still not allow a sufficient margin for access seekers. In such a scenario, the Commission would invite TKK to consider differentiating the costing methodologies in certain geographical markets, where sufficient competitive safeguards stemming from the alternative networks exist.

BEREC's Assessment

First of all, BEREC would like to point out that the Commission in its serious doubt letter did neither comment nor expressed serious doubts regarding TKK's SMP decision defining both market 4 and market 5 with regards to geographical reach as national. Additionally, BEREC assumes that in its analysis, the Commission agreed with TKK that the characteristics of the

Austrian markets do not provide any arguments for a geographical differentiation of regulatory remedies applied in the defined national markets. Therefore, BEREC understands that the Commission does not propose any conclusive regulatory remedy addressing particularly low margin squeeze free prices of ULL in Austria resulting from the definition of different geographic markets or from the geographical differentiation of remedies in the same geographic market.

BEREC generally shares the view of the Commission that NRAs should in principle impose cost-oriented prices based FL-LRAIC model. However, BEREC notes that taking into account a gradual shift from a copper to an NGA network when modelling the price, as recommended by the Commission in its serious doubts letter, does not stem from the NGA Recommendation, which is in place since 2010 and inter alia sets principles for the pricing of NGA access, or any other Framework act already in force, but seems to originate in the draft Commission recommendation on non-discrimination and costing methodologies, not yet adopted by the Commission at the time of TKK's market analysis and subsequent notification. BEREC finds it odd if the Commission expects TKK to base the features of its cost model on any act that has not yet been formally adopted and published in the Official Journal of the European Union. Such signals to take into account any draft documents not only complicate the work of NRAs (in terms of predicting the contents of the draft that will actually be adopted), but also significantly increase the possibility of a successful challenge of any subsequent regulatory decisions based on such drafts in front of national courts. Furthermore, urging NRAs to base any aspects of their decisions on draft Recommendations or other acts, which are not yet formally adopted and appropriately published, also undoubtedly lowers regulatory predictability for all market players that might be the subjects or beneficiaries of such regulatory decisions.

Also, the Commission expresses its concerns that insufficient representation of shift towards NGA in the model could lead to rising unit costs due to declining copper volumes. BEREC points out that TKK has provided in its draft decision for market 4, the total number of FTTH lines of all the operators, which do not exceed ten thousand. Besides, as indicated in the RFI for the market 4 by TKK, in 2007 the cost-oriented unbundling price was €10,70. BEREC understands that even though the significance of the copper volume effect on the ULL prices at that time was much lower than in 2013, the cost oriented-prices were still well above the margin squeeze free prices (approx. €6).

Nevertheless, BEREC examined the Commission's comment on the missing feature of the Austrian pricing model and tried to hypothetically assess, if taking it into account would actually lower the cost oriented price to a level that would allow a sufficient margin for access seekers and would at the same time be acceptable to the Commission. Taking into account the gradual shift from copper to an NGA network would in view of the Commission help address rising costs due to declining copper volumes as it would "deal appropriately and consistently with the impact of declining volumes caused by the transition from copper to NGA networks, i.e. avoiding an artificial increase in wholesale copper access prices, which would otherwise be observed as a result of customers migrating to the NGA network of the SMP operator.[8]" As Commission further notes in the draft Non-discrimination and costing methodologies Recommendation: "Active copper lines are decreasing due to customers

[8] Recital 25 of the draft Commission recommendation on non-discrimination and costing methodologies.

migrating to cable, fibre and/or mobile networks. Modelling a single efficient NGA network for copper and NGA access products neutralises the inflationary volume effect that arises when modelling a copper network, where fixed network costs are distributed over a decreasing number of active copper lines. It allows for progressively transferring the traffic volume from copper to NGA with deployment of and switching to NGA. Only traffic volume moving to other infrastructures (for example cable, mobile), which are not included in the cost model, will entail a rise in unit costs[9]."

BEREC by undertaking an analysis of hypothetical implementation of the draft Non-discrimination and costing methodologies Recommendation finds that TKK sufficiently showed that traffic volumes over copper access products are in fact not decreasing because of customers migrating to the NGA network of the SMP operator, but that the decrease is a consequence of traffic volume moving to other infrastructures (mostly mobile and to some extent cable), which are not included in the cost model. In accordance with these findings, BEREC points out that even if TKK was able to take into account the draft Recommendation in this regard, the increase in the LLU price calculated with the use of a costing model would still seem to be in line with it.

The Commission also points out the incorrect treatment of the valuation of civil infrastructure, which in BEREC opinion in market 4 and 5 regards mostly ducts. It has to be emphasised that in its draft decision TKK pointed that "[...] ducts have only a small share in the A1 access network as most of the subscriber loops are run in cables of different strengths that are directly buried in the ground. Ducts in the access network are currently less widespread and are frequently not continuous for stretches from the main distributor to the network completion point. Instead they are available only for small stretches (especially around a main distributor)". This suggests that the treatment of the valuation of ducts in the Austrian case is insignificant with regard to the end price output of the model. Even if TKK has adopted such feature in its model, it would have had limited impact on lowering of the ULL price.

Furthermore, the Commission argues that the inclusion of OPEX was undertaken incorrectly in TKK model. According to BEREC expertise, construction and digging costs make up to 80% of all costs of the market 4 and 5 services. The operating costs make up only a small share of total costs. Furthermore, a pure change of the step in the calculation at which the operating costs are added (regardless of whether inside or outside the model) cannot lead to any significant changes of the results, and in theory, should not lead to any change in the results. Therefore the Commission's comment regarding the treatment of the OPEX brings no value to the analysis of the case in BEREC's opinion.

BEREC also emphasises that the features of a LRAIC model that are suggested by the Commission in its serious doubts letter seem to be directly linked to the Recommendation on non-discrimination and costing methodologies. BEREC once again points to the fact that the Recommendation is not yet adopted, and therefore any references to it by the Commission are not appropriate at this time and should not be taken into account in the analysis of regulatory remedies of any particular NRA.

[9] Recital 39 of the draft Commission recommendation on non-discrimination and costing methodologies.

To sum up, the crucial point with regard to the Commission comments on the TKK model is that the details on costing issue are not relevant, since it is the margin squeeze calculation that determines the ULL price. Any result from an adapted cost model either:

a) is higher that the prevailing price and thus causes a margin squeeze,

b) is exactly the prevailing price and therefore does not lead to any change, or

c) is below the prevailing price which would further reduce the price of ULL leading to further concerns of the Commission,

whereas points (b) and (c) are unlikely as explained above in the BEREC Assessment. Since the Commission does not provide any valid solution for treatment of margin squeezed prices resulting from the cost model, BEREC is of the opinion that this concern of the Commission is not sufficiently justified and lacks any constructive recommendation for TKK.

5. CONCLUSIONS

On the basis of the economic analysis set out in section 4 above, BEREC considers that the Commission's serious doubts regarding the draft decision of the Austrian Regulatory Authority on the lack of sufficient evidence supporting the choice of price regulation, as expressed in the Commission's letter to TKK of 25 July 2013, are not justified.

BEREC is of the opinion that TKK has presented sufficient evidence during the notification process to justify its choice of price regulation method on market 4 and 5. Furthermore, BEREC does not agree with the Commission's conclusion of having identified an inconsistency of the price regulation between market 4 and 5. BEREC also is of the opinion that the Commission's concerns with regard to the TKK's LRAIC model are of little significance to the case.