

**BEREC Opinion on
Phase II investigation
pursuant to Article 7a of Directive 2002/21/EC as amended by
Directive 2009/140/EC:**

**Cases IT/2013/1489-1490
Review of wholesale prices on markets 4 and 5 in Italy**

20 September 2013

TABLE OF CONTENTS

- 1. EXECUTIVE SUMMARY 1
- 2. INTRODUCTION 1
- 3. BACKGROUND 2
- 4. ASSESSMENT OF THE SERIOUS DOUBTS 6
- 5. CONCLUSIONS..... 17

1. EXECUTIVE SUMMARY

On 12 July 2013, the Commission registered a notification by the Italian Regulatory Authority, *Autorità per le garanzie nelle comunicazioni* (AGCOM), concerning the markets for (physical) network infrastructure access (market 4) and wholesale broadband access (market 5).

In the notified decisions AGCOM has proposed to set the regulated prices for full and shared local loop un-bundling (LLU), sub-loop unbundling (SLU) and the related collocation services, as well as for wholesale broadband access (WBA) for 2013, in the context of the assessment of the Reference Offer proposed by Telecom Italia for 2013. In market 4, the price was set based on cost orientation (BU-LRAIC), for full LLU at €8.68, for shared LLU at €0.86 and for SLU at €5.79. In market 5, AGCOM proposed price control for WBA based on cost orientation (BU-LRAIC), added with a 3% “investment promotion” mark-up. The price for shared WBA was set at €6.74 and for naked WBA at €15.14.

On 12 August 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 lack of sufficient evidence to update the price control obligations on markets 4 and 5 outside of the current market review.

The Commission has serious doubts as to the compatibility with EU law of the approach followed by AGCOM in the implementation of the price control obligation and the setting of the wholesale access prices for 2013 in markets 4 and 5. The Commission considers that the proposed measure would create a barrier to the single market in light of the unstable and unpredictable approach used to impose wholesale access prices on Telecom Italia.

On the basis of the analysis set out in this Opinion, BEREC considers that the Commission’s serious doubts are not justified. BEREC is of the opinion that AGCOM has presented sufficient evidence during the notification process to justify its choice of time and methodology for an update of prices on markets 4 and 5. AGCOM should however add some of the information provided in response to the Commission’s RFI to relevant parts of the final price decisions.

2. INTRODUCTION

On 12 July 2013, the Commission registered a notification by the Italian Regulatory Authority, AGCOM, concerning the markets for (physical) network infrastructure access and wholesale broadband access in Italy (corresponding to markets 4 and 5 in Commission Recommendation 2007/879/EC of 17 December 2007). On 18 July 2013 and 23 July 2013, the Commission sent requests for information (RFIs) to AGCOM, and responses were received on 24 July 2013. Additional questions were sent to AGCOM on 25 July 2013 and responses were received on 29 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 on 12 August 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 19 August 2013, the EWG sent a first list of questions to AGCOM. Answers were received from AGCOM on 21 August 2013. A second list of questions was sent on 20 August 2013 and the answers received on 22 August 2013.

The EWG met on 22 August 2013 in Stockholm. During this meeting the EWG also met with AGCOM to gather further information and clarification in response to the questions previously sent. In addition, some further questions were also raised by the EWG. 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 11 September 2013 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 20 September 2013. This opinion is now issued by BEREC in accordance with Article 7a(3) of the Framework Directive.

3. BACKGROUND

Timeline and previous notifications

Markets 4 and 5

In 2009, the second review of the markets 4 and 5 in Italy were notified and assessed by the Commission under cases IT/2009/0891 and IT/2009/0892 in two steps. First, AGCOM defined the market and designated Telecom Italia (TI) with significant market power (SMP) in both wholesale markets. Subsequently, AGCOM notified its proposed remedies which the Commission assessed under case numbers IT/2009/0988 and IT/2009/0989.

With regard to market 4, AGCOM imposed access to the copper network (full and shared access (LLU) and sub-loop unbundling (SLU), access to passive infrastructures (cable, ducts, etc.) and dark fibre, transparency, non-discrimination, cost accounting, accounting separation and price control (network cap for copper based access and fair and reasonable prices for access to passive infrastructure and dark fibre).

Regarding market 5, AGCOM imposed bit-stream access (including naked bit-stream) over copper and fibre loops at different levels, transparency, non-discrimination, cost accounting, accounting separation and price control.

BU-LRAIC

In 2010, AGCOM notified its BU-LRAIC model and set a price cap for TI's wholesale prices for LLU and WBA in the period 2010-2012, on the basis of a glide path towards the calculated BU-LRAIC based tariff for 2012. The respective notification was assessed by the Commission under case IT/2011/1133. AGCOM did not carry out a separate cost analysis for the WBA service but derived the prices for this service from the calculated LLU BU-LRAIC prices over a glide-path. AGCOM set a network cap and increased WBA prices by the annual percentage increase of the LLU price. AGCOM applied the same approach to the wholesale

line rental¹ (WLR) service, with the objective of preserving the existing "economic space" between the prices of LLU, WBA and WLR services. The Commission urged AGCOM to verify the validity of the maintenance and commercial costing data in its model, in line with the BU-LRAIC methodology employed. It further invited AGCOM to analyse whether WLR and WBA services were not priced inconsistently with the BU-LRAIC model applied.

Under cases IT/2011/1230 and IT/2011/1231, the Commission assessed AGCOM's notifications with regard to the proposed full set of remedies for Next Generation Access in markets 4 and 5.

Third round of market analyses

In September 2012, with decision n. 390/12/CONS, AGCOM started the procedure concerning the third market review of markets 1, 4 and 5.

Interim measure

According to the remedies decision of 2009, AGCOM's review of TI's Reference Offer is the standard procedure for updating regulated access prices.²

On 18 October 2012, AGCOM adopted a decision³ setting an interim measure according to which the wholesale access prices in 2012 would also be temporarily extended to 2013, and this, contrary to the standard procedure, until the recently initiated reviews of markets 1, 4 and 5 were finalised and the new remedies imposed. Following the adoption of the new market analysis, the new 2013 wholesale access prices would have been put in place retroactively starting from 1 January 2013.

TI's 2013 Reference Offer

On 31 October 2012, TI published its 2013 Reference Offer for markets 4 and 5.

WLR

On 31 October 2012 also, AGCOM notified its proposal to set cost oriented WLR prices from 1 June 2012 to 31 December 2012, thereby removing the network cap. AGCOM calculated the network costs of the WLR service on the basis of the BU-LRAIC model applied for setting the LLU price. This notification was assessed by the Commission under case IT/2012/1384.

In its notification and information submitted in relation to case IT/2012/1384, AGCOM explained that it was carrying out an overall assessment of the competitive conditions in the provision of WLR, LLU and WBA services in the context of the third round market review of

¹ Access obligation in market 1.

² At the end of October each year, TI must publish its Reference Offer for the following year, and AGCOM will then review it in the following months before final approval.

³ DELIBERA N. 476/12/CONS. In article 1 p.1 of the decision, AGCOM states that "Starting from the 1st of January 2013 and until the end of the conclusion of the proceeding of market analysis started with decision n. 390/12/CONS, Telecom Italia transitorily applies the economic conditions provided for in its Reference Offer approved for the year 2012, to the wholesale access services based on the copper network (unbundled access, bit-stream access and Wholesale Line Rental) subject to the network cap regime" (EWG translation).

In article 1 p.2 AGCOM states that "The economic conditions for the year 2013 for the above cited wholesale access services to the copper network, will be defined within the market analysis launched with decision n. 390/12/CONS, and will take place starting from 1 January 2013" (EWG translation).

the corresponding relevant markets. It expected to notify this review to the Commission by the second quarter of 2013.

On 30 November 2012, in response to the notification, the Commission asked AGCOM to assess the consistency between the WLR, LLU and WBA prices, respectively, and revise them at the latest in the context of the next review of the corresponding relevant markets. In this regard, the Commission stressed that the proposed modification of WLR prices affected the consistency between LLU, WBA and WLR prices during the second half of 2012, since the "economic space" between the now cost oriented WLR product and the WBA products (still subject to the old regulatory regime) was likely to change. The Commission also invited AGCOM to consider whether setting new WLR prices with retroactive effect might lead to legal uncertainty for market players.

High Court Ruling

On 28 March 2013, the Italian Highest Administrative Court (Consiglio di Stato) partly annulled AGCOM's decisions 731/09/CONS and 578/10/CONS (case numbers IT/2009/0988-0989 and IT/2011/1133 described above) regarding price control obligations and the definition of the BU-LRAIC cost model applicable for wholesale access products.

Consultation of third market review

On 4 April 2013, AGCOM launched the national consultation on the third review of markets 1, 4 and 5.

Current notification

The notified draft measures concern implementation of the price control obligation⁴ imposed on TI in 2009, regarding markets 4 and 5. In particular, AGCOM proposed to set the regulated prices for full and shared LLU, SLU and the related collocation services, as well as for WBA for 2013, in the context of the assessment of the Reference Offer proposed by TI for 2013. This Reference Offer was published by TI on 31 October 2012. Any final decision by AGCOM following its current notification would have retroactive effect, starting as from 1 January 2013.

In response to the Commission's request for information, AGCOM put forward the following arguments for why it has not proposed to set the above mentioned wholesale access prices for 2013 on the basis of the market review that was subject to public consultation on 4 April 2013:

- At the beginning of 2013, AGCOM observed that the higher complexity of the required evaluation and the longer formal consultation procedure could not allow it to set prices as a result of a market review before the end of 2013.
- AGCOM decided to urgently apply cost orientated WBA prices, as suggested by the Commission in its comments in case IT/2012/1384, in order to ensure consistency as to the cost standards and the cost basis adopted for LLU, WBA and WLR services.

⁴ Case numbers IT/2009/0988-0989

- AGCOM decided to finalise the assessment of the reference offer for the 2013 LLU prices in the first half of 2013, (i) in light of the evidence showing a significant reduction of maintenance and commercial costs for the provision of the LLU service and (ii) due to the requests made by many alternative operators since the end of 2012 asking for a timely revaluation of WBA and LLU prices for 2013 reflecting this cost reduction.

Market 4

Full LLU monthly fee

AGCOM proposes to set the LLU prices for 2013 on the basis of the BU-LRAIC model applied for setting the LLU prices during the period 2010-2012. The price modifications that AGCOM envisages result from updating the following parameters: (i) the volume of lines which affects the network unit costs, (ii) the mark-up applied for calculating the commercial costs and (iii) the cost of manpower, the line failure rate and the intervention rate, which are key factors in the calculation of maintenance costs.

AGCOM also assesses the relevant Weighted Average Cost of Capital (WACC) for the 2013 tariff valuations, and proposes to maintain it at the level which was calculated in 2010 (i.e. 9.36%). Previously, within the national consultations on the LLU prices for 2013 and the review of markets 1, 4 and 5, AGCOM proposed to set the WACC at 9.83% and 10.40%, respectively.

The resulting monthly fee for full LLU (in €) is equal to €8.68.

Shared LLU monthly fee

AGCOM proposes to set the monthly fee for shared LLU at €0.86 per month, which would only comprise commercial costs and maintenance costs. Network costs are not considered, as the incumbent recovers these via the retail telephone subscription.

SLU monthly fee

AGCOM proposes to set the monthly fee for SLU at €5.79. AGCOM explains in the reply to the Commission's RFI that this monthly fee is not based on the BU-LRAIC model, since there was no such model developed in 2010, but on TI's proposal in the Reference Offer for 2013 (which proposed a monthly fee equal to 2/3 of the monthly LLU fee)⁵. In the reply to the Commission's RFI, AGCOM also points out that it is developing a specific BU-LRAIC cost model for SLU in the context of its current full market review.

Market 5

Instead of setting the WBA prices by reference to the LLU price and increasing the WBA prices by the annual percentage increase of the LLU price, as in the past, AGCOM proposes to set the monthly fee for WBA on the basis of the BU-LRAIC model that is also applied to set the prices for LLU and WLR. AGCOM also adds a mark-up of 3% to the BU-LRAIC based WBA cost, in line with the ladder of investment principle, and with the aim of promoting the

⁵ A 67% ratio between the SLU and the full LLU tariffs has been applied since 2009.

deployment of infrastructures. AGCOM considers that this mark-up secures an adequate "economic space" between the different wholesale access products⁶.

The resulting monthly fees for the shared and naked WBA services prices would be €6.74 and €15.14 respectively.

Next price cap for the period 2014-2016

AGCOM states that the wholesale access prices proposed for 2013 constitute the reference prices of the new glide path to be applied in the period 2014-2016. In its reply to the Commission's request for information, AGCOM explains that the 2016 target access prices will be based on the new BU-LRAIC model. The target value will be reached by taking the 2013 rates as the starting point and, following a glide path in the years 2014 and 2015, move towards the 2016 target rate.

AGCOM further explains that the target prices for 2016 will be based on the evaluation of the maintenance and commercial costs set out in the current notification, in order to ensure the predictability and the stability of the wholesale access prices proposed for 2013. For example, AGCOM indicates that LLU repair maintenance costs will start from the value obtained in 2013, which results from a lower fault rate observed in the access network.

Serious doubts

In addition to commenting on the need for transparency and coherence in the notification of remedies under the EU consultation procedure, the Commission has serious doubts as to the compatibility of AGCOM's draft measures with EU law, and considers that they create barriers to the single market. Specifically, the Commission expresses serious doubts regarding the lack of sufficient evidence to update the price control obligations on markets 4 and 5 outside of the current market review.

4. ASSESSMENT OF THE SERIOUS DOUBTS

On 12 August 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 compliance with Articles 8(4) and 13(1) and (2) of the Access Directive in conjunction with Article 8 of the Framework Directive, in particular:

⁶ In its reply to questions additional to the Commission's request for information, AGCOM explains that it has considered the higher investment risk (as compared to WBA) that an alternative operator faces when collocating its DSLAM at TI's local exchange. According to AGCOM the non-recurrent costs (i.e. set up costs) and costs for DSLAMs are considered to be riskier investments, because they cannot be recovered in case of business failure. AGCOM has quantified this through a risk premium of 4% to be added to the WACC (i.e. 9.36%). The application of such premium, in the BU-LRAIC model, provides a mark-up of about 0.5 euro/month, which would correspond to 3% of the proposed access monthly fee of €15.14.

- Serious doubts regarding the lack of sufficient evidence to update the price control obligations on markets 4 and 5 outside of the current market review.

Concerns of the Commission

While the Commission recognises that NRAs have a margin of discretion in updating and modifying the price control remedy to regulate access rates, the Commission 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.

Against this background, the Commission is greatly concerned at the element of arbitrariness in AGCOM's approach for setting prices in markets 4 and 5, in particular with respect to AGCOM's departure from its course of action initially envisaged and communicated to stakeholders only some nine months ago. According to the Commission, this lack of consistency of AGCOM's regulatory action over time unnecessarily generates additional regulatory risks, and undermines the principle of regulatory predictability enshrined in the EU Regulatory Framework, which is of particular importance for investments in Next Generation Access (NGA) networks for which Italy is lagging behind compared to other Member States.

AGCOM's notified measures raise serious doubts as to its compatibility with EU law regarding the following legal provisions under Union law:

a) Compliance with Article 8(5)a of the Framework Directive

According to Article 8(5)a of the Framework Directive, NRAs shall promote regulatory predictability by ensuring a consistent regulatory approach over appropriate review periods. The Commission notes that, contrary to what it had notified the Commission of on 31 October 2012, AGCOM does not notify any wholesale access price for 2013 which would follow a market review of the corresponding relevant markets. AGCOM had indicated that it expected to notify market review-based access prices by the second quarter of 2013.

The Commission further notes that AGCOM started in September 2012 to carry out full reviews of markets 1, 4 and 5, and adopted in October 2012 a decision setting an interim measure according to which the wholesale access prices in 2012 would be extended to 2013 until the market review was finalised.

Instead of using its well progressed market review, and contrary to its own decision of last October, AGCOM proposes the above mentioned access prices in the context of the assessment of the Reference Offer proposed by TI for 2013. In this proceeding, AGCOM updates the BU-LRAIC model that it applied in 2010 to set the LLU prices for the period 2010-2012 and proposes to apply the same (updated) BU-LRAIC model for setting WBA prices.

The Commission has serious doubts that such a regulatory approach can ensure regulatory predictability and stable planning conditions for market players. The latter must have had legitimate expectations that any modifications in the wholesale access prices for 2013 would only follow full market reviews, given that (i) AGCOM started such reviews in September 2012, (ii) it decided in October 2012 to maintain the existing access prices until the reviews were finalised, and the market data from the last review (of 2009) must have been considered outdated.

The Commission believes that AGCOM could have notified without much delay the LLU, WBA and WLR prices for the next regulatory period, on the basis of valid and up-to-date market reviews, once the Commission Recommendation on consistent non-discrimination obligations and costing methodologies was adopted in early September 2013.

The Commission has nevertheless taken due account of AGCOM's argument that its present notification would need to be assessed in light of the fact that it had to implement the comments made by the Commission, originally in 2010 and, by way of reiteration, in 2012, concerning the calculation of the maintenance and commercial costs and the consistency between the WLR, LLU and WBA prices. It nevertheless believes that AGCOM's justification is flawed. Specifically, the Commission believes:

- AGCOM should have addressed the Commission's comments of 2010 and 2012 earlier, in the prices adopted between 2010 and 2012, but in any event not by way of a separate proceeding on 2013 LLU access prices.
- The latter fails to incorporate in the BU-LRAIC model the more recent data for commercial and maintenance costs as well as data resulting from the on-going market review in a way that runs counter to the legitimate expectations generated by AGCOM's own decision to use interim measures to extend the 2012 wholesale access prices to 2013, and to modify the latter only following a full review of the corresponding relevant markets.

The Commission has also taken due account of AGCOM's argument that it needs to address TI's current proposal for voluntary separation, and that this would prolong the time necessary for a full market review. The Commission considers that TI's planned voluntary functional separation cannot be used as an argument for adopting the notified measures, instead of notifying without undue delay the results of the on-going full market review. Rather AGCOM should, in addition, start conducting a separate coordinated review in relation to TI's voluntary separation.

b) Compliance with Article 8(5)d of the Framework Directive

Article 8(5)d of the Framework Directive stipulates that NRAs shall promote efficient investment and innovation, whilst ensuring that competition in the market is preserved.

In this respect, the Commission has serious doubts that the notified WACC would reflect the currently prevailing competitive conditions, and contribute to the required transparency and robustness regarding this relevant parameter.

Specifically, the Commission notes that in a short interval of time between the launch of the public consultation on the 2013 LLU prices and the public consultation on the market reviews, AGCOM proposed two different values for the WACC which differed considerably (i.e. 9.83% and 10.40%, respectively).

In its present notification, AGCOM elected to maintain the WACC that was calculated in 2010, i.e. 9.36%, rather than any of the values consulted upon, and calculate the 2013 LLU access price on that basis. Given (i) the number of parameters to be considered when calculating the WACC, (ii) the changes that have occurred in the Italian economy over the past three years and, in particular, in the financial markets and (iii) the previous higher

estimates of the WACC, the Commission has serious doubts as to the validity of the value chosen for the parameter in question.

The Commission is particularly concerned in this respect, as a comparison with other Member States currently facing similar financial difficulties, such as Spain and Portugal, reveals that the WACCs used in those countries differ considerably from AGCOM's approach.

To conclude, the Commission has serious doubts that the WACC value, being a subject of frequent changes by AGCOM, promotes efficient investment and innovation, whilst ensuring that competition in the market is preserved.

c) Compliance with Article 8(5)c of the Framework Directive and Article 13(2) of the Access Directive

According to Article 8(5)c of the Framework Directive and Article 13(2) of the Access Directive, NRAs shall safeguard competition to the benefit of consumers, and promote efficiency and sustainable competition. The Commission has serious doubts that, by adding a mark-up of 3% when setting the WBA prices, and by setting the SLU price at 2/3 of the LLU price, AGCOM is effectively setting cost oriented wholesale access prices and therefore safeguarding and promoting competition in the Italian broadband markets.

Indeed, the Commission observes in this regard that the mark-up of 3% results from applying a risk premium of 4% to the WACC for certain assets in which an LLU-based alternative operator has to invest. AGCOM does not explain how it calculates this risk premium or how TI calculates the ratio of 2/3 to derive the SLU price. On the basis of the information available to the Commission it cannot be excluded that the above parameters were set in an arbitrary way.

The Commission reiterates that the fact that AGCOM (i) is developing a cost model for calculating the SLU price, and (ii) foresees applying it when imposing remedies in the context of the full market reviews, clearly calls for not implementing the modifications notified, for SLU and the setting of the corresponding prices, prior to the full market review.

d) Compliance with Article 3(3) of the Framework Directive: principle of transparency

According to Article 3(3) of the Framework Directive, national regulatory authorities should exercise their powers impartially, transparently and in a timely manner.

The Commission has serious doubts that the draft measures would contain a clear indication of the methodology which AGCOM followed for setting parameters such as (i) the WACC when setting the LLU prices, (ii) the mark-up over the BU-LRAIC based WBA cost when setting the WBA prices and (iii) the ratio between LLU and SLU prices when setting the SLU price in the absence of a cost model. Prices seem to have been set rather arbitrarily and, in any event, without the necessary methodological rigour. This approach does not appear to comply with the principle of transparency.

Creation of barriers to the internal market

The Commission has serious doubts that the lack of regulatory predictability and transparency of the approach followed by AGCOM is furthering the establishment and

development of trans-European networks, thus creating barriers to further market integration. Specifically the procedure to set wholesale access prices appears to result in unstable and unpredictable prices.

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 is 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 problem⁷. Therefore, the decision on when and how to update regulated prices lies fully within the authority of an NRA, as long as it complies with the regulatory framework.

In its serious doubts letter to AGCOM, the Commission recognises that NRAs have a margin of discretion in updating and modifying the price control remedy 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 AGCOM may choose the appropriate time and methodology for an update of prices, as long as AGCOM can properly justify its choice.

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

BEREC's assessment

a) Compliance with Article 8(5)a of the Framework Directive

Concerns of the Commission

In the Commission's opinion, AGCOM should have addressed the Commission's comments of 2010 and 2012 earlier, in the prices adopted between 2010 and 2012, but in any event not by way of a separate proceeding on 2013 LLU access prices. The proposed measure runs counter to the legitimate expectations generated by AGCOM's own decision to use interim measures to extend the 2012 wholesale access prices to 2013, and to modify the latter only following a full review of the corresponding relevant markets. The Commission has serious doubts that such regulatory approach can ensure regulatory predictability and stable planning conditions for market players.

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

BEREC's assessment

With regard to the Commission's objection to AGCOM's deviation from its course of action initially envisaged and communicated to stakeholders in October 2012⁸, BEREC is of the view that AGCOM has fully justified its deviation in its reply to question 2 (footnote 3) of the Commissions RFI, of 24 July 2013.

As explained in its reply, every year AGCOM updates TI's wholesale tariffs by approving TI's Reference Offers (ROs)⁹. The yearly process of approving TI's ROs involve the launch of public consultations on each one of the ROs submitted by TI to AGCOM, and the adoption by AGCOM of final decisions approving TI's ROs at the end of the consultation period.

AGCOM also explains that this "*process (the annual reference offer approval process) is generally (even though in some cases, when deemed necessary, the market analysis decisions may provide the definition of reference offer prices) accomplished outside the market analysis process which is aimed at providing the high level SMP obligations related to price control.*"

BEREC notes that the formal approval of TI's wholesale tariffs is normally done outside of the market analysis process. This is the normal procedure¹⁰ in force in Italy, based on the valid market analysis and SMP-decisions¹¹, which all stakeholders on the market expect to take place every year, and which ensures predictability and stability in the markets.

Regarding the Commissions opinion that AGCOM could have notified without much delay the LLU, WBA and WLR prices for the next regulatory period on the basis of a valid and up-to date market review once the Commission Recommendation on consistent non-discrimination obligations and costing methodologies was adopted in early September 2013, AGCOM explained both in its notified decisions and in its reply to question 2 of the Commissions RFI why it deviated from its previously announced intention.

AGCOM realised at the beginning of 2013 that, due to the higher complexity of the evaluations involved which in turn would lead to a longer formal consultation procedure, the third round of market analyses would not allow setting the final 2013 prices before the end of 2013. Moreover, the disclosure at the end of 2012 of evidence indicating a significant reduction of LLU operative costs, such as corrective maintenance costs and commercial costs, made AGCOM decide it had to complete the assessment of TI's reference offer within the first half of 2013.

⁸ DELIBERA N. 476/12/CONS and Case IT/2012/1384.

⁹ In article 6, comma 3, of Decision No 731/09/CONS which imposes an obligation of transparency on TI, AGCOM states that "Telecom Italia publishes on a yearly basis, before the 31 October of every year, the Reference Offers for the services listed at comma 1 for the next year, which the Authority approves with eventual modifications. The approved Reference Offer is valid starting from the 1st of January of the reference year and the effects of the approval, unless specified otherwise, take effect retroactively in respect to the date of approval of the Reference Offer. To this purpose, for the arrears before the approval of the Reference Offer, Telecom Italia applies the last offer conditions approved by the Authority" (EWG translation).

¹⁰ See Resolutions No 28/11/CIR, No 89/11/CIR, No 93/12/CIR, No 29/11/CIR, No 90/11/CIR, 158/11/CIR, No 37/12/CIR, No 93/12/CIR and No 94/12/CIR.

¹¹ Resolutions No 314/09/CONS and No 731/09/CONS, the latter annulled by court ruling, see footnote 13.

Most important, a ruling by the Italian Highest Administrative Court (Consiglio di Stato) of 28 March 2013¹² (described in section III.4.4, D.20 of the notified draft Decision on market 4) partly annulled AGCOM's decision 731/09/CONS and subsequent decision 578/10/CONS regarding the definition of the BU-LRAIC cost model applicable for wholesale access products, with particular reference to the valuation of LLU corrective maintenance costs made by AGCOM in the 2010-2012 network cap. Hence, AGCOM was forced to urgently assess and make a decision regarding the 2013 LLU and WBA prices.

Regarding AGCOM's decision in the beginning of 2013 to urgently approve WBA prices by applying the cost orientation approach, i.e. the BU-LRIC model from 2010, BEREC observes that AGCOM only complied with the Commission's request¹³ to have coherence in 2013 of the cost standards and cost basis adopted for LLU, WBA and WLR services.

Regarding the Commission's opinion that the 2013 prices for LLU and WBA are based on market data from the last review (2009) and thus outdated, BEREC finds this incorrect. As explained in AGCOM's reply to question 6 of the Commission's RFI, the mark-up for commercial costs which was used for setting the 2013 prices has always been obtained from the latest regulatory accounting data using a top down approach, in this case data for 2010 and 2011. Regarding maintenance costs, these are evaluated according to the latest regulatory accounting data, as well as data obtained from stakeholders during the public consultations. Furthermore, as explained by AGCOM in its reply to question 7 of the Commission's RFI, maintenance costs will be evaluated according to the same model and parameters for the 2014-2016 period.

Taking into account all the information provided by AGCOM in the notified decisions and the reply to the Commission's RFIs, BEREC finds that AGCOM has sufficiently justified its regulatory approach. In BEREC's opinion, AGCOM has acted as should be expected from an NRA under the prevailing circumstances. Hence, BEREC finds that the Commission's serious doubts, that AGCOM's regulatory approach does not ensure regulatory predictability and stable planning conditions for market players, are not justified.

b) Compliance with Article 8(5)d of the Framework Directive

Concerns of the Commission

The Commission has serious doubts that the notified WACC value, being a subject of frequent changes by AGCOM, promotes efficient investment and innovation, whilst ensuring that competition in the market is preserved. The Commission is particularly concerned that AGCOM has chosen to maintain the WACC value calculated in 2010. According to the Commission, this measure would not actually reflect the currently prevailing competitive conditions in Italy, and furthermore it would not contribute to the required transparency and robustness regarding this relevant parameter.

BEREC's assessment

In paragraph 36 of section III.3.4 of the draft decision on market 4, AGCOM describes the method of the WACC calculation which was already decided upon in 2010¹⁴. Furthermore,

¹²N. 01856/2013REG.PROV.COLL., N. 08478/2012 REG.RIC.

¹³ Commission letter case IT/2012/1384, 30 November 2012.

¹⁴Appendix C of Resolution No 121/10/CONS and final Resolution No 578/10/CONS.

the parameters and sources of information that were used in 2010 are explained in paragraph 36, in particular the gearing ratio, the risk free rate, the equity beta, the risk premium and the cost of debt capital.

In paragraph 37, AGCOM presents the re-evaluation of the WACC and all of its parameters as it was set out in the draft decision which was subject to public consultation¹⁵. This re-evaluation of the WACC leads to a value equal to 9.83%.

In section III.4.2, AGCOM presents the remarks made by operators in the public consultation. In paragraphs D.13 to D.16, the comments made by alternative operators (requesting a significantly lower WACC) as well as those made by Telecom Italia (requesting a higher WACC) are presented in detail, and analysed in respect of every parameter.

In section III.5.4, AGCOM lays down its own considerations in response to the comments made by alternative operators and by Telecom Italia. In paragraphs D.46 to D.57, this analysis is made in considerable detail and in reference to every single one of the relevant parameters.

In paragraphs D.58 to D.66, AGCOM once more discusses every parameter in detail and brings forward its arguments and conclusion on the WACC. Finally, AGCOM decides to maintain the WACC established by Decision No 578/10/CONS, which is 9.36%.

To sum up the draft decision on market 4, AGCOM deals with the WACC extensively and analyses every parameter in detail.

In its reply to the Commissions RFI of 24 July 2013, AGCOM explains that in the public consultation, it was proposed to either maintain the WACC (9.36%) or to modify it to 9.83% by an update of some parameters. The final decision of AGCOM not to update the WACC is based on several reasons:

First, during the national consultation most of the stakeholders requested not to modify the 2010 WACC, but to update the WACC for 2014-2016 during the next market analysis.

Secondly, an in-depth analysis of the parameters of the WACC showed that no modification was needed:

Regarding the risk-free rate (3.9% in 2010), the analysis showed a highly oscillating day by day trend, with an average monthly value of 3.96%. The difficult interpretation of this oscillating trend and the slight distance of the average value with respect to the 2010 value, suggested not modifying the 2010 value. This line of reasoning is also explained in section III.5.4, paragraph D.62, of the draft decision on market 4.

Regarding the cost of debt capital (5.61% in 2010), the data analysed during the public consultation, also provided by stakeholders, suggested values not very different (up to 1.88%) to the previous spread value of 1.71%. Therefore AGCOM decided not to modify the previous value of the cost of debt capital of 2010. This argumentation is set out in paragraph D.63. In addition, Telecom Italia reported a cost of debt value in its "Annual Report 2012" of 5.4%, and 5.3% in the "Interim report of 31 March 2013".

¹⁵ Public consultation 27 March 2013 to 12 May 2013 (Delibera n. 221/13/CONS).

For the equity risk premium (4.5% in 2010) AGCOM used an update of the same study used in 2010 which provides a value of 3.5% and 3.4% (geometric mean). Other analysts, however, provide higher values (up to 5.8%) using different models. The presence of contrasting quantitative indications caused AGCOM to confirm the previous value of 2010. This argumentation is set out in paragraph D.64.

According to AGCOM all other parameters included in the WACC evaluation did not show any relevant modifications with respect to the values used in Decision No 578/10/CONS. In conclusion, AGCOM confirms the WACC to have a value of 9.36% (paragraph D.66).

Having assessed the in-depth explanations of AGCOM's draft decision and the reply to the Commissions RFI, BEREC concludes that AGCOM has sufficiently justified its decision regarding the WACC for 2013. Hence, BEREC finds that the Commissions serious doubts are not justified.

c) Compliance with Article 8(5)c of the Framework Directive

Concerns of the Commission

The Commission has serious doubts that, by adding a mark-up of 3% when setting the WBA prices, and by setting the SLU price at 2/3 of the LLU price, AGCOM is effectively setting cost oriented wholesale access prices and therefore safeguarding and promoting competition in the Italian broadband markets. On the basis of the information available to the Commission it cannot be excluded that the above parameters were found in a rather arbitrary way.

The Commission reiterates that the fact that AGCOM (i) is developing a cost model for calculating the SLU price and (ii) foresees to apply it when imposing remedies in the context of the full market reviews does clearly call for not implementing the modifications notified, for SLU and the setting of the corresponding prices, prior to the full market review.

BEREC's assessment

SLU monthly fee

In Annex B to its public consultation on the approval of TI's 2013 reference offer for market 4, the content of which is also recalled in section III.3.7 of the notified draft decision, AGCOM proposes to apply to the SLU monthly fee a percentage change equal to the one calculated for the full LLU monthly fee.

As the price range for SLU tariffs was obtained by applying to the 2012 SLU tariff the same variations proposed for the LLU tariff, this left by definition the ratio between the SLU tariff and the LLU tariff between 2012 and 2013 unchanged at 66.7%.

In section III.4.7, footnote 22, it is stated that: "Over the years, starting from the alignment with the Danish rates of 2003, the rate of SLU was subjected to the same price change expected for the full ULL, except for the year 2009 in which the price of the previous year was confirmed". A table also shows that the 67% ratio between the SLU and the full LLU tariffs has been applied since 2009.

BEREC understands that, having been in use since 2009, the 67% ratio has been accepted by the market players as a reasonable approximation of a cost oriented price for SLU. The

principle of adjusting the SLU price with the same percentage as for full LLU has also, with one exception, been a standard procedure for several years.

In this decision, according to the standard procedure, AGCOM proposes to adjust the price of SLU with the same percentage calculated for full LLU. Hence, being a result of an established standard procedure for adjusting the price, BEREC does not share the Commission's view that the 67% ratio was determined in an arbitrary way.

In its response to question 9 of the Commission's RFI, AGCOM explains that the sub-loop unbundling monthly fee was not based on a BU-LRIC model since such model was not developed in 2010. AGCOM also points out that in the third round of market analysis, it will develop a specific BU-LRIC cost model for SLU.

In the absence of a fully developed BU-LRIC model, the methodology used so far by AGCOM, consisting of applying a normative cost ratio to the BU-LRIC full LLU calculation, must in BEREC's opinion be as valid for 2013 as it has been between 2009 and 2012.

Given the circumstances explained above, BEREC is of the view that AGCOM's decision not to deviate from the methodology used since 2003, and the ratio between the LLU and SLU monthly fee used since 2009, is sufficiently justified and ensures a consistent regulatory approach. Therefore, BEREC finds that the Commission's serious doubts are not justified.

Mark-up on WBA

BEREC's assessment

As pointed out in section IV.1 of the notified draft decision for market 5, AGCOM considered it appropriate to carry out, as quickly as possible, a review of the naked bit-stream fees, in order to restore the correct economic space between wholesale access services (LLU, WLR, and WBA) by 2013. In light of the demands made by some operators and the request from the Commission 30 November 2012 in case IT/2012/1384, this regulatory action would ensure cost certainty and predictability to the market.

In section IV.1.2, AGCOM explains why a mark-up is needed. The Authority decided the mark-up was in accordance with the principle of the ladder of investment. Specifically, the mark-up creates an appropriate economic space between infrastructure operators and operators that use the bit-stream to the values of BU-LRIC costs given above, and so encourages infrastructure development. To this end, it is reasonable to expect a mark-up of the order of 3%.

In section IV.2, D.31, AGCOM presents the remarks made by operators in the public consultation. In section IV.3, D.43, AGCOM confirms the application of the optical infrastructure premium for the promotion of investment in network access. This is in line with the regulatory policy (national and Community) for the promotion of infrastructure competition on both copper and fibre networks.

In its response to question 10 of the Commission's RFI, of 29 July 2013, AGCOM further elaborated on the quantification of the proposed mark-up. AGCOM's assessment is based on a consideration of the higher investment risk with respect to bit-stream that an operator, collocating its DSLAM in TI's local exchange, has to face. The proposed mark-up of 3% results from adding a risk premium of 4% to the WACC (9.36%) for certain assets (non-

recurrent costs and DSLAMs) in which an LLU-based alternative operator should invest and which cannot be recovered in case of business failure.

AGCOM considered the risk premium of 4% following the public consultation results concerning the Reference Offer for NGA bit-stream services in market 5 by Decision n. 10/13/CIR (Delibera n. 10/13/CIR of 28 February 2013). In its decision AGCOM pointed out that the 4% regulatory non systematic risk premium is based on similar values proposed by other NRAs which were known at that time (specifically OPTA, Netherlands – with 3,5%). AGCOM's final conclusions are reported in paragraph D.47 of the above mentioned Decision n. 10/13/CIR, where AGCOM confirms a risk premium of 4% for new investments in optical infrastructure.

The 4% value for the asymmetric risk premium is again confirmed by international benchmarking¹⁶ in Decision n. 238/13/CONS of 21 March 2013, regarding public consultation concerning the identification and analysis of the service markets for access to the fixed network (markets 1, 4 and 5 among those identified in the 2007/879/EC Recommendation), published on 4 April 2013. In the notified draft decision for market 5 (section “Methodology for evaluation of the remaining services previously subject to network cap”) there is clear reference to the Decision n. 238/13/CONS.

Considering that AGCOM uses a 4% optical infrastructure premium when calculating BU-LRAIC based fees in market 4¹⁷, BEREC finds it reasonable to use the same value in market 5. Also, a 4% infrastructure premium is in line with the value used in e.g. Spain.

Therefore, BEREC does not share the Commission's view that the mark-up was found in an arbitrary way. BEREC is of the view that AGCOM's decision to apply a 3% mark-up has been sufficiently justified, and finds that the Commission's serious doubts are not justified.

d) Compliance with Article 3(3) of the Framework Directive

The Commission has serious doubts that the draft measures would contain a clear indication of the methodology which AGCOM followed for setting parameters such as (i) the WACC when setting the LLU prices, (ii) the mark-up over the BU-LRAIC based WBA cost when setting the WBA prices and (iii) the ratio between LLU and SLU prices when setting the SLU price in the absence of a cost model. Prices seem to have been set rather arbitrarily and, in any event, without the necessary methodological rigour. This approach does not appear to comply with the principle of transparency.

BEREC's assessment

In the previous sections, BEREC has declared that (i) AGCOM has sufficiently justified its decision regarding the WACC for 2013, (ii) AGCOM's decision to apply a 3% mark-up has been sufficiently justified, and (iii) AGCOM's decision not to deviate from the methodology used since 2003, and the ratio between the LLU and SLU monthly fee used since 2009, is sufficiently justified. BEREC does not share the Commission's view that prices have been set arbitrarily and without the necessary methodological rigour. Hence, BEREC finds that the Commission's serious doubts are not justified.

¹⁶ See Table 3 in Annex H to Decision n. 238/13/CONS (Allegato H alla Delibera n. 238/13/CONS).

¹⁷ See Delibera n. 9/13/CIR, paragraphs 183 and D.70, and Delibera n. 10/13/CIR, paragraphs 103-105 and D.47.

5. CONCLUSIONS

On the basis of the analysis in section 4 above, BEREC considers that the Commission's serious doubts regarding the draft decision of the Italian Regulatory Authority, on the lack of sufficient evidence to update the price control obligations on markets 4 and 5 outside of the current market review - as expressed in the Commission's letter to AGCOM 12 August 2013 – are not justified.

BEREC is of the opinion that AGCOM has presented sufficient evidence during the notification process to justify its choice of time and methodology for an update of prices on markets 4 and 5. AGCOM should however add some of the information provided in response to the Commission's RFI to relevant parts of the final price decisions.