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**BEREC Guidance on the regulatory accounting  
approach to the economic replicability test  
(i.e. ex-ante/sector specific margin squeeze tests)**

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## Workflow and drafters

- Drafting team chaired by AKOS and BNetzA
- 15 NRAs included in the drafting team
- Cooperation with MEA EWG for the chapter: Margin squeeze in the context of competition law and differences with the ex-ante approach

## Purpose of the document

- The Recommendation on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment 2013/466/EU foresees the economic replicability test (ERT) as the element to safeguard competition in case of non-imposition of regulated wholesale access prices.
- The purpose of the Guidance document is to set out the possible methodologies for NRAs to run the economic replicability test in accordance with current practice with ex-ante/sector specific margin squeeze tests.
- The Guidance document aims to compare the similarities and differences between the ERT and ex-ante margin squeeze tests and therefore describes the common methodologies already used by NRAs in practice.
- The Guidance document is taking into consideration all existing documents of the Commission, BEREC, ERG and also contains a chapter on margin squeeze tests in competition law practice (including ECJ jurisdiction).

## Structure of the document

1. Introduction
2. Parameters of the ex-ante economic replicability test as applied by the Commission Recommendation on consistent ND and costing methodologies (Annex II)
3. Basic methodological choices of the ex-ante margin squeeze mechanics currently applied by NRAs (current practice)
4. Economic rationale and implementation of the ex-ante economic replicability test of the Recommendation in practice
5. Procedural and transparency issues
6. Margin squeeze in the context of competition law, differences with the ex-ante approach
7. Conclusions

## Questionnaires and results

### Questionnaires for NRAs:

- **The Margin squeeze questionnaire on current practice of NRAs** in order to obtain the data on the current practice (Ch.3)
- **The Questionnaire on procedural and transparency issues** (Ch.5)

Both questionnaires were answered by nearly all NRAs.

Results are analyzed in the relevant chapters and results shown in detail in Annex B of the Guidance document.

## Main findings and conclusions (1)

### Primary objective

The primary objective of the ex-ante economic replicability test is to safeguard competition in cases where no other cost-oriented price regulation pursuant to Art. 13 Directive 2002/19/EC is imposed. Moreover, the ERT is used to ensure non-discrimination and transparency, preventing exclusion from the market.

### Definition of the test

The ex-ante economic replicability assesses whether the SMP operator's retail price ( $RP_{smp}$ ) of the 'flagship product(s)' or the products considered relevant by the NRA covers the regulated wholesale costs ( $WC_{reg}$ ), non-regulated input costs (incl. own network costs;  $WC_{non-reg}$ ) and retail costs (LRIC+;  $RC$ ).

Formula:

$$RP_{smp} \geq WC_{reg} + WC_{non-reg} + RC.$$

## Main findings and conclusions (2)

### Level of efficiency of the operator

The majority of NRAs use the REO/adjusted EEO test as the preferential level of efficiency while the Recommendation starts with the EEO test, but allowing scale adjustments if the SMP operator has frustrated the market entry or where very low volumes of lines and their significantly limited geographic reach as compared to the SMP operator's NGA network indicate that objective economic conditions do not favour the acquisition of scale by alternative operators.



## Main findings and conclusions (3)

### Relevant cost standard

Categories of costs as mostly used by NRAs:

- Regulated wholesale costs: LRIC+
- Non-regulated input costs: LRIC+
- Retail costs: FAC (extracted from SMP operators accounts and adjusted in case of REO/adjusted EEO)

NRAs must ensure consistency when using a combination of cost standards.

### Depreciation method

Any relevant depreciation method such as economic depreciation, straight line depreciation, tilted annuity, and other depreciation methods are applicable. Straight line depreciation is chosen by most NRAs for practical reasons.

### Reasonable profit

Economic replicability should support efficient build or buy signals, so the investments from alternative operators should be stimulated when efficient. There should be a non-negative margin of the retail price of the product offered by the SMP operator and the sum of the costs necessary to provide the downstream service, so an efficient operator would be allowed to earn a reasonable rate of return.

WACC is clearly the preferred option of NRAs to calculate the reasonable profit.

## Main findings and conclusions (4)

### Retail costs

Relevant cost categories (marketing, customer acquisition, billing, customer care, bad debt, CPE/distribution of CPE, product development/management ) with a reasonable mark-up for common costs added.

Cost categories depend on tested retail product.

### Average user: the relation between wholesale/retail traffic/pricing

The relation between wholesale and retail traffic and pricing could be based on either call minutes/download data included in the retail product or an average end-user consumption profile.

### Regulated wholesale costs

Wholesale prices from the SMP operator's reference offers under a LRIC(+) cost standard approach (imputation). In cases where there is only an access obligation NRA should consider the access price that the SMP operator effectively charges third-party access seekers for the relevant regulated wholesale input with volume based discounts taken into account.

### Non-regulated input costs (incl. own network costs)

- If available: the information on the network costs of the alternative operator
- Or: SMP operator's costs to assess the non-regulated input costs (LRIC+)
- Alternatively the prices commercially agreed on the carrier market could be used.

## Main findings and conclusions (5)

### Time Period

Depending on the type of investment costs to be depreciated:

- Customer related investments (e.g. marketing, connection, customer retention): to spread the cost evenly over the expected average customer lifetime;
- Non-customer related investments (e.g. physical equipment): the useful economic life of the asset.

### Relevant retail products

#### Flagship products

Flagship products might be defined as the product that generates the highest revenue share or the one with the highest market share.

Other criteria to select the flagship products might be possible e.g. advertising costs as suggested by the Recommendation. Most of the NRAs consider it appropriate to submit a wider set of retail products to the current margin squeeze test (as it is used as a complementary tool).

#### Level of aggregation of products

To be decided by the individual NRA on the basis of the assessment of competition problems identified in the market analysis.

The guidance document considers that the use of a product-by-product approach ensures that each bundle/standalone offer is replicable and that there can be no form of cross-subsidy between bundles/standalone offers. The document admits that from an economic perspective efficiency gains may be better covered by an aggregated assessment approach. 11

### Relevant retail products

#### Bundles

Bundles need to be considered in the margin squeeze analysis, especially when they constitute “flagship products”. The definition of bundles is not limited to those bundles which are composed only of regulated elements. From BEREC’s point of view, if bundled products are relevant in the market, they need to be included in the analysis.

The NRAs would determine the way these components are taken into account according to national circumstances.

#### Revenues / retail price

In order to determine if there is a margin squeeze between the upstream and downstream level that all downstream revenues and attributable revenues to the bundle/standalone service should be considered in the assessment.

In this regard it is important to take into account level of aggregation and treatment of standalone and bundled products.

#### Promotions and temporary discounts

As promotions and temporary discounts can be an important element to determine the actual retail costs they should be taken into account. As they can take very different forms in the different markets, NRAs should have flexibility how to take them into account in the margin squeeze test.

The NRAs should check whether “the SMP operator offers at the wholesale level to its own retail arm are the same than those offered to third parties and if these conditions do not threat competition in the retail market”, thus ensuring a level playing field.

A possible measure could be an ex-ante communication obligation which entails that operators have to communicate in advance to the NRA the commercial tariffs and discounts, that they are about to launch to the consumers in order to ensure the sufficiency, including economic conditions, of wholesale obligations

## Main findings and conclusions (7)

### Geographical segmentation

BEREC considers that it is appropriate that NRAs may analyze and determine the competitive conditions in the different geographic areas within the country, in order to decide whether it is advisable to define a separate sub national market, or to impose geographically differentiated remedies on a sub national basis, even if markets are defined as been national in scope.

When performing a replicability test, the NRAs should examine the replicability of the relevant retail offer by taking into account the wholesale inputs used in the specific geographic areas (urban/densely populated areas and rural) bearing in mind the objectives to ensure competition and promoting NGA investments.

## Main findings and conclusions (8)

### Procedural and transparency issues

The transparent procedure in place for conducting an economic replicability test, included in the market analysis decision, NRAs should have a certain degree of flexibility when designing their procedure.

Imposing an obligation on the SMP operator to communicate to the NRA the launch of his retail offers is relevant in the context of the procedure of the ERT as foreseen by the Recommendation, given that the latter one considers the launch of new offers as the trigger event for starting the procedure.

Article 10 of the Authorisation Directive empowers the NRA to ask operators to provide additional information or up-to-date information on costs and volumes under.

In case the result of the ERT is not compliant with economic replicability obligations, the squeeze must be eliminated.

BEREC considers that the NRA should request the SMP operator to amend the wholesale and/or the retail price or to withdraw the retail offer (based on Art. 10 of the Authorisation Directive).

It is also possible that the SMP operator amends or withdraws the offer on its own initiative.

In accordance with Article 10 of the Authorisation Directive, the NRA can apply proportionate measures, including financial penalties to ensure compliance with economic replicability obligations.

## Next steps and further timing

| Task   | Date                           |
|--|--------------------------------|
| Plenary 3: Discussion and approval for public consultation at Plenary 3  | 26th September 2014            |
| Public consultation  | 29th Sept. - 24th October 2014 |
| Presentation at the Stakeholder Forum                                    | 16th October 2014              |
| CN 4: Discussion and approval to pass on to Plenary for adoption         | 13/14th November 2014          |
| Plenary 4: Discussion and adoption of the final document and publication | 4/5th December 2014            |