Body of European Regulators for Electronic Communications

BEREC

BoR (14) 160

BEREC Opinion on

Phase II investigation

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

Case DE/2014/1642

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

22 October 2014

Contents

1. EXECUTIVE SUMMARY

On 11 August 2014, the Commission registered a notification from the German national regulatory authority, Bundesnetzagentur (BNetzA), concerning the market for call termination on individual public telephone networks provided at a fixed location in Germany (corresponding to market 3 in Commission Recommendation 2007/879/EC of 17 December 2007).

In case DE/2012/1359[1] BNetzA proposed to define markets for call termination on individual public telephone network at a fixed location including call forwarding, and designated 57 operators as having SMP on their relevant markets. The Commission had no comments as to the market definition and the SMP assessment with respect to the market for wholesale fixed call termination. In case DE/2013/1430[2], BNetzA *inter-alia* set fixed termination rates (FTRs) of Telekom Deutschland GmbH (DT) using a LRAIC+ methodology. In case DE/2013/1460[3], BNetzA set the fixed termination rates of two alternative SMP operators[4] by way of setting symmetrical rates benchmarked against the FTRs of DT.

In the presently notified draft measures, BNetzA proposes to set price control obligations for the remaining 54 alternative SMP operators also by way of setting symmetrical rates benchmarked against the FTRs of DT. The actual level of FTRs for these SMP operators was set at ***0.36 €c/min (peak)*** and ***0.25 €c/min (off-peak)*** to apply retrospectively, as of 1 December 2012, and limited until 30 November 2014.

On 10 September 2014 the Commission sent a serious doubts letter opening a phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC. The Commission's doubts relate to the compatibility with EU law of BNetzA's proposed measures concerning price control remedies for the wholesale markets for call termination on individual public telephone networks at fixed locations in its current form, due to the methodology used to calculate the costs of services. These concerns stemmed from BNetzA's use of a LRAIC+ methodology, rather than the pure BU-LRIC costing methodology recommended by the Commission[5], without providing a valid justification for this deviation.

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

In line with BEREC previous opinions[6] issued concerning BNetzA's proposed FTRs on DT, Netzquadrat and T&Q, BEREC, while appreciating that symmetry is implemented, considers

---

[1] C(2012) 5904

[2] C(2013) 2064; a more detailed description of this case is presented in the "Background" section.

[3] C(2013) 4011; a more detailed description of this case is presented in the "Background" section.

[4] Gesellschaft für Telekommunikation mbH (Netzquadrat) and T&Q Netzbetriebs GmbH (T&Q).

[5] Commission Recommendation 2009/396/EC of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (Termination Rates Recommendation), OJ L 124, 20.5.2009, p. 67.

[6] BoR (13)55 and BoR (13)94

that the Commission's serious doubts are justified. In particular, BNetzA's proposed FTRs are not based on a pure BU-LRIC costing methodology and no valid justification has been provided for such deviation. Moreover, BNetzA has neither proved that the potential impacts of applying pure BU-LRIC based tariffs on operators and/or consumers would justify a departure from pure BU-LRIC, nor has it proved that its proposal would be better suited to meet the policy objectives of promoting efficiency and sustainable competition and maximize consumer benefits than the recommended pure BU-LRIC one.

In addition, BEREC shares the Commission's serious doubts that, if adopted, BNetzA's proposal could create barriers to the internal market as BNetzA's proposal is based on an alternative methodology to that recommended by the Commission without valid justification, whose application leads to significantly higher FTRs in Germany as compared with the average pure BU-LRIC tariffs of other countries that have set tariffs based on pure BU-LRIC (via a bottom-up model or benchmark).

To rectify this, and to maintain symmetry, BEREC suggests BNetzA set the symmetrical FTRs for all SMP operators in Germany at the level of pure BU-LRIC costs and at the earliest opportunity possible.

2. INTRODUCTION

On 11 August 2014, the Commission registered a notification from the German national regulatory authority, BNetzA, concerning the market for call termination on individual public telephone networks provided at a fixed location in Germany (corresponding to market 3 in Commission Recommendation 2007/879/EC of 17 December 2007). On 21 August 2014, a request for information (RFI) was sent to BNetzA and a response was received on 26 August 2014.

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 10 September 2014. 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.

Answering the EWG, BNetzA confirmed the issues on the chosen costing methodology, the economic analyses, the evidences and impact analysis were already provided in the previous cases. The EWG met on 24 September 2014 in Vilnius with the objective of sharing understanding of the notified documents and deciding whether, based on the information available thus far, it could reach clear conclusions on whether or not the Commission's serious doubts are justified. The EWG reached preliminary conclusions on the issues by analysis of the relevant documents.

A draft opinion was finalized on 21 October 2014 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 22 October 2014. This opinion is now issued by BEREC in accordance with Article 7a (3) of the Framework Directive.

3. BACKGROUND

Previous notifications

The third round of market analyses of the market for call termination on individual public telephone networks provided at a fixed location in Germany was previously notified to and assessed by the Commission under DE/2012/1359[7]. At the time BNetzA notified its proposal for market definition and the assessment of significant market power (SMP).

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

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

On 6 March 2013 and on 21 May 2013, under cases DE/2013/1430[8] and DE/2013/1460[9] respectively, BNetzA notified the Commission of its draft measures concerning remedies to be imposed on DT and on two alternative SMP operators[10]. In these draft measures, BNetzA proposed to impose, among others, the following obligations: interconnection and conveyance obligations, co-location obligations for interconnection purposes and price control obligations. With regards to the obligation of cost-orientation, BNetzA proposed in case DE/2013/1430 to set (retrospectively, as of 1 December 2012 to 31 December 2014) the FTRs for DT at 0.36 €c/min (peak) and 0.25 €c/min (off-peak). BNetzA calculated these rates based on a LRAIC+ cost methodology. As regards the cost orientation obligation in a subsequent case (DE/2013/1460), BNetzA proposed setting symmetrical rates for Netzquadrat and T&Q, through benchmarking FTRs of DT in case DE/2013/1430. The remaining 54 alternative SMP operators in the fixed voice call termination markets committed to charge in reciprocity the provisional termination rates of DT as of 1 December 2012.

On 8 April 2013 and on 20 June 2013, the Commission expressed its serious doubts as to the compatibility of these proposals with EU law concerning the price control remedies for call termination, due to the methodology used to calculate the costs of services.

On 17 May 2013 and on 1 August 2013, BEREC issued two opinions[11] considering that in each of these cases, the Commission's serious doubts were justified in that BNetzA's proposed FTRs were not based on a pure BU-LRIC costing methodology and no valid justification was provided for such deviation. BEREC also recommended that BNetzA should set symmetrical FTRs for all SMP operators at pure BU-LRIC levels.

[7] C(2012) 5904

[8] C(2013) 2064

[9] C(2013) 4011

[10] Netzquadrat and T&Q

[11] BoR (13)55 and BoR (13)94

On 8 August 2013[12] and on 21 October 2013[13], the Commission issued two Recommendations for BNetzA to implement pure BU-LRIC fixed termination rates in Germany no later than 1 November 2013 and respectively, no later than 1 February 2014.

Current notification

In the currently notified draft measure, BNetzA proposes to impose on the remaining 54 alternative SMP operators – i.e. those other than DT, Netzquadrat and T&Q – the following FTRs: 0.36 €c/min (peak) and 0.25 €c/min (off-peak), symmetrical with the FTRs notified under cases DE/2013/1430 and DE/2013/1460.

Given the proposed national benchmarking[14], the suggested FTRs under the current notification, whilst being symmetrical, will rely on the same LRAIC+ methodology used for the FTRs for DT. This means that non-traffic related costs, such as rental and common costs, are included in the cost model for FTRs on which the final level is based.

BNetzA states that the relevant provisions of the German telecommunications law (TKG) have to be interpreted in the light of EU law in general and the Termination Rates Recommendation in particular, and that – in case of conflict – methods set out by the Commission prevail over the regulatory default model set out by national law.

In line with the case DE/2013/1430, which dealt with the FTRs imposed on DT which is the benchmark for the proposed FTRs for the remaining 54 SMP operators, BNetzA also argued that its approach is justified by the need to comply with the TKG and to take into account the actual characteristics of the German Telecommunications market.

BNetzA therefore justifies its decision not to follow a core part of the Termination Rates Recommendation by alleging that the LRAIC+ approach will contribute to the development of the internal market and is better suited to meet the policy objectives provided for in Article 8(1) of the Framework Directive and in Article 8(4) of the Access Directive. Further to this, according to BNetzA, pure BU-LRIC would neither better support the interest of other fixed operators or of citizens and end-users. Finally, BNetzA considers that calculation of FTRs according to pure BU-LRIC would increase the difference between fixed and mobile termination charges, and that the LRAIC+ approach for setting FTRs is better suited to reduce the gap between FTRs and mobile termination rates (MTRs)[15]. Applying pure BU-LRIC would, according to BNetzA, significantly reduce the revenues of fixed operators, thus hampering their investment capacities.

Commission's serious doubts

[12] C(2013) 5112, case DE/2013/1430

[13] C(2013) 6884, case DE/2013/1460

[14] FTRs of DT are taken as a reference to establish symmetry between DT, Netzquadrat, T&Q and the remaining 54 alternative SMP operators currently in question. These rates in turn were determined by BNetzA on the basis of an LRAIC+ approach in case DE/2013/1430.

[15] For the calculation of MTRs BNetzA uses the LRAIC+ approach that has been investigated by the Commission and BEREC in C(2013)3954 case DE/2013/1424 and C(2014)4291 case DE/2014/1605. In these cases, the Commission's serious doubts regarding the use of LRAIC+ approach were also justified.

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

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

The Commission observes that BNetzA uses a national benchmarking approach and proposes to set fixed termination rates benchmarked against the rates of DT, that are based on a LRAIC+ methodology which – contrary to Recommends 2 and 6 of the Termination Rates Recommendation – allocates non-traffic related costs to the provision of the fixed termination service.

The Commission underlines that, given the characteristics and the associated competitive and distributional concerns of termination markets[16], the objectives of promoting efficiency and sustainable competition, maximizing consumer benefits and contributing to the development of the internal market would best be achieved by a cost orientation obligation remedy based on a pure BU-LRIC methodology and a narrow definition of the increment.

Reiterating the main issues expressed under cases DE/2013/1430 and DE/2013/1460, the Commission does not share BNetzA's view that its proposed method is better suited (than pure BU-LRIC) to serve the policy objectives of promoting competition and protecting EU citizens' interests, at least not without providing further evidence of the effects for the choice of costing methodology.

Moreover, the Commission maintains its observation that fixed termination rates set at an efficient level contribute to a level playing field among operators by eliminating competitive distortions between fixed and mobile networks in the provision of termination services. Also, the Commission notes that, when deciding on the correct level of the regulated wholesale termination rate, it is essential to ensure that the methodology promotes efficient production and consumption decisions and minimizes artificial transfers and distortions between competitors and consumers.

The Commission recognized that NRAs can deviate from the Termination Rates Recommendation, but an alternative methodology should be duly justified in light of the policy objectives and regulatory principles of the Regulatory Framework.

The Commission also observes that although the benchmarked cost model is NGN-based, it allows for the recoupment of some PSTN costs. However the cost model should be based on efficient technologies available in the time frame considered by the model in order to promote efficiency. Therefore, the core network of a model built today should ideally be NGN-based, to the extent that the costs of such a network can be reliably identified. However, in BNetzA’s model PSTN costs account for significant amount of the FTR level. In view of the impact of this on the final FTR level and the prospective replacement of PSTN with IP technology by an efficient operator, the Commission considers that BNetzA could have reduced the share of PSTN related costs on a forward looking basis.

Furthermore, the Commission notes that reconciliation exercises can be performed in order to identify the sources of differences, to quantify those differences and to make appropriate adjustments accordingly with a view to assist in the verification of pure BU-LRIC models.

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

However, BNetzA's approach to reconciliation starts from DT's data, rather than a model of a hypothetical efficient operator and makes adjustments to it for inefficiencies. This makes it difficult to assess to what extent the proposed adjustments were sufficient to address DT's potential inefficiencies.

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

The Commission considers that BNetzA neglects the fact that a pure BU-LRIC approach is better suited to facilitate a more efficient distribution of financial transfers between competing operators, thus ultimately minimizing the risk of problems such as cross-subsidization between operators, inefficient pricing and/or investment behavior.

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

The Commission also observes that the evidence gathered so far confirms the significant consumer welfare gains result from pure BU-LRIC FTRs, and therefore does not share BNetzA's view that its proposed method is better suited to protecting EU citizens' interests.

Creation of barriers to the internal market

The Commission notes that the application of a LRAIC+ methodology leads to a considerable difference, in absolute terms, between German FTRs (resulting from BNetzA's proposed approach) and those of other Member States which employ a pure BU-LRIC methodology in compliance with the Termination Rates Recommendation and in line with Articles 8(4) and 13(2) of the Access Directive.

Any such considerable asymmetries in fixed termination rates within the EU not only distort and restrict competition but have a significant detrimental effect on the development of the internal market, i.e. create a considerable barrier to the single market, and, therefore, result in a violation of the principles and objectives of Article 8(2) and (3) of the Framework Directive.

A harmonized approach in setting FTRs is particularly important to ensure that regulators do not favor their national operators at the expense of operators in other Member States by not introducing fully cost-oriented termination rates.

4. ASSESSMENT OF THE SERIOUS DOUBTS

The Commission's serious doubts correspond largely to those that were raised in the serious doubts letters in cases DE/2013/1430, DE/2013/1460 regarding FTRs and in cases DE/2013/1424, DE/2014/1527 and DE/2014/1605 regarding mobile termination rates. As in those cases, BEREC fully agrees with the European Commission. BEREC believes the criticisms put forward by it on case DE/2013/1460[17], in section 4 "Assessment of the Serious Doubts" remain fully valid in this case. These refer to:

- Legal issues – despite Germany's national law, BNetzA has a requirement to demonstrate that a deviation from the Termination Rates Recommendation is better suited to meet the policy objectives and regulatory principles of the underlying Directives. This would (at least) require that all the arguments set out in the Termination Rates Recommendation be analyzed so that it can be effectively demonstrated that the pure BU-LRIC approach is less appropriate to fulfil the Directives' regulatory principles than the approach adopted by BNetzA.

- Methodological issues – for example, BEREC is of the view that BNetzA should have analyzed what a competitive outcome would look like, considered external effects and the recovery gap.

- Competition issues – for example, BNetzA should have conducted a more detailed investigation of fixed-fixed competition issues, the call balances of smaller and larger operators, and the effects of the LRAIC+ FTRs on mobile networks.

- Technological issues – in choosing which technology to model, BNetzA should have taken the forward-looking approach, including a transition to NGN. Although hybrid PSTN/NGN models are not ruled out, these should be based on a bottom-up model of an efficient operator, rather than the incumbent's costs. Furthermore, the technologies employed should be justified by reference to an efficient operator, rather than simply adding a mark-up of PSTN costs on top of an NGN model.

- Negative impacts which the regulation would have in creating barriers to the internal market.

Moreover, BEREC is of the opinion that simultaneously bringing the costing methodology in line with pure BU-LRIC for all market participants is of equal importance and would have presented the least risk for unjustified market distortion.

As a result of BNetzA's LRAIC+ methodology adopted in this, and previous, cases, FTRs in Germany are, without valid justification, significantly higher than the FTRs from other countries that have set tariffs based on the recommended pure BU-LRIC approach.

BEREC has already raised all the concerns above in case DE/2013/1430 and has reiterated them in case DE/2013/1460. Therefore all relevant conclusions on case DE/2013/1430 and DE/2013/1460 can also be drawn for the present case.

[17] BoR (13)94 – BEREC opinion on Phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC: Case DE/2013/1460 – Call termination on individual public telephone networks provided at a fixed location (market 3) in Germany; 01.08.2013.

5. CONCLUSIONS

On the basis of the analysis set out in section 4 above, BEREC considers that the Commission's serious doubts are justified in that (i) BNeztA's proposed approach to set FTRs is not based on a pure BU-LRIC costing methodology which, as recommended by the Commission, results in a better competitive outcome, and (ii) BNetzA has not provided valid justifications for deviating from the Termination Rates Recommendation. In particular, BNetzA has neither proved that the potential impacts of applying pure BU-LRIC based tariffs on operators and/or consumers would justify a departure from pure BU-LRIC, nor has it proved that its proposal would be better suited to meet the policy objectives of promoting efficiency and sustainable competition and maximize consumer benefits than the pure BU-LRIC. BNetzA therefore did not prove that national circumstances justify the deviation from the recommended FTRs costing methodology.

In addition, BEREC shares the Commission's concerns that if adopted, BNetzA's proposal could create barriers to the internal market when other NRAs set FTRs based on the methodology recommended by the Commission while BNetzA deviates from that methodology without valid justification.

In the light of the Commission's serious doubts and the argumentation above, BEREC recommends BNetzA set the FTRs for all SMP operators in Germany at the level of pure BU-LRIC costs and at the earliest opportunity.