Body of European Regulators
for Electronic Communications

BEREC

BoR (14) 206

BEREC Opinion on

Phase II investigation

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

Case DE/2014/1660

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

15 December 2014

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1. EXECUTIVE SUMMARY

On 7 October 2014, the Commission registered a notification from the German national regulatory authority, Bundesnetzagentur (BNetzA), concerning the markets for call origination on individual public telephone networks provided at a fixed location and call termination on individual public telephone networks provided at a fixed location in Germany (corresponding to markets 2 and 3 in Commission Recommendation 2007/879/EC of 17 December 2007).

In the presently notified draft measures, BNetzA proposes to set price control obligations for DT using a LRAIC+ methodology. The actual uniform level of fixed termination rate (FTR) for DT was set at ***0.24 €c/* min**[1] to apply as of 1 December 2014 until 31 December 2016.

On 6 November 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 serious 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[2], 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 Article 8(4) and Article 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.

This is not the first time that BNetzA was asked by the Commission to align notified measures with the methodology recommended by the Commission in relation to setting the right level of FTRs. Namely, two previous cases[3] were also setting FTRs in Germany based on LRAIC+ model.

In case DE/2012/1359 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 in 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, BNetzA, inter-alia, set fixed termination rates of Telekom Deutschland GmbH (DT) using a LRAIC+ methodology. In case DE/2013/1460, BNetzA set the fixed termination rates of two alternative SMP operators by way of setting symmetrical rates benchmarked against the FTRs of DT.

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[1] BNetzA specifies that there is no reason anymore to differentiate tariffs according to peak and peak-off hours since the costs incurred during peak and off-peak hours do not differ anymore and is not applied by DT.

[2] 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.

[3] Case DE/2012/1430, Case DE/2014/1460 and Case DE/2014/1642

In case DE/2014/1642 BNetzA proposed 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 for Case DE/2014/1642 pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC.

In line with BEREC's previously issued opinions[4] concerning BNetzA's proposed FTRs, BEREC considers that the Commission's serious doubts are justified. In particular, BNetzA's proposed FTRs have deviated from the Commission's recommended pure BU-LRIC costing methodology without a valid justification having been provided for such a deviation. Moreover, BNetzA has neither demonstrated that the potential impacts of applying LRAIC+ based tariffs on operators and/or consumers would justify a departure from pure BU-LRIC, nor has it demonstrated that its proposal would be better suited to meet the policy objectives of promoting efficiency and sustainable competition and maximizing consumer benefits than would be the case under the recommended pure BU-LRIC methodology.

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 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 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 7 October 2014, the Commission registered a notification from the German national regulatory authority, BNetzA, concerning the markets for call origination on the public telephone network provided at a fixed location and call termination on individual public telephone networks provided at a fixed location in Germany (corresponding to markets 2 and 3 in Commission Recommendation 2007/879/EC of 17 December 2007). On 14 October 2014, a request for information (RFI) was sent to BNetzA and a response was received on 17 October 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 6 November 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

[4] BoR (13)55, BoR (13)94 and BoR(14)160

independent BEREC opinion on the justification of the Commission's serious doubts on the case.

Responding to the EWG, BNetzA confirmed that it used the same LRAIC+ model as notified to the Commission under cases DE/2013/1429-1430. Contrary to cases DE/2013/1429-1430, BNetzA confirmed that in the current notified draft measure, BNetzA proposes to apply for the first time one single call termination fee, without the distinction for peak and off peak hours.

Since this Phase II case is very similar to other cases (DE/2013/1430, DE/2013/1460 and DE/2014/1642), the rapporteur decided in agreement with the experts of the EWG and in accordance with point B. III. b) of the Internal Guidelines for the elaboration of BEREC Opinions in Article 7 and 7a Phase II cases (BoR(13) 112) to exercise the work without an initial meeting. Instead, the EWG held a videoconference on 20 November 2014 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 analyzing the relevant documents.

A draft opinion was finalized on 12 December 2014 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 15 December 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[5]. 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[6] and DE/2013/1460[7] respectively, BNetzA notified the Commission of its draft measures concerning remedies to be imposed on DT and on two alternative SMP operators[8]. In these draft measures, BNetzA proposed to impose, among others, the following obligations: interconnection and conveyance

[5] C(2012) 5904

[6] C(2013) 2064

[7] C(2013) 4011

[8] Netzquadrat and T&Q

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 30 November 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 set out 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[9] 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.

On 8 August 2013[10] and on 21 October 2013[11], the Commission issued two Recommendations for BNetzA to implement pure BU-LRIC fixed termination rates in Germany no later than 1 November 2013 and no later than 1 February 2014, respectively.

On 11 August 2014 under Case DE/2014/1642 BNetzA notified the Commission its draft measure concerning the market for call termination on individual public telephone networks provided at fixed locations in Germany in which BNetzA proposed 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 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 22 October 2014, as in previous cases, BEREC issued an opinion considering that in this case, 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.

Current notification

In the currently notified draft measure, BNetzA proposes to impose on DT the following uniform

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

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

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

FTR: 0.24 €c/min as of 1 December 2014 until 31 December 2016.

The notified FTR is based on the same LRAIC+ cost model, developed by WIK for broadband and interconnection markets, as applied in Case DE/2013/1430. BNetzA indicates in the draft measure that its approach is not in accordance with Recommends 2 and 6 of the Commission's Termination Rates Recommendation.

BNetzA states, as in previous cases, 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.

However, BNetzA remains of the view, as expressed in case DE/2013/1430, that LRAIC+ should be used as a basis for the calculation of termination rates.

BNetzA therefore justifies its decision not to follow a core part of the Termination Rates Recommendation by alleging that it would have to be proven that the recommended model addresses the identified market failures better than the German LRAIC+ model.

In order to ensure recovery of DT's costs due to parallel running of two networks, PSTN based and NGN based, the LRAIC+ model is NGN based and uses current costs, but at the same time allows for the recoupment of PSTN costs. BNetzA claimed that this approach is in compliance with the German TKG.

BNetzA plans to notify corresponding price caps to be imposed on other operators previously identified with SMP on their respective fixed voice call termination markets, at the beginning of 2015. Price caps imposed on other SMP operators will be symmetrical to the one imposed on DT retrospectively as of 1 December 2014.

Commission's serious doubts

The Commission expresses serious doubts regarding the price control remedy 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 points out that by proposing a LRAIC+ instead of a pure BU-LRIC costing methodology BNetzA chooses not to follow a core part of the Termination Rates Recommendation, in particular Recommends 2 and 6 thereof.

The Commission underlines that, given the characteristics and the associated competitive and distributional concerns of termination markets[12], 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 ensuring that termination rates are implemented at cost efficient, symmetrical level and as of 31 December 2012. In that respect,

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

the Commission states that efficient rate is normally one resulting from a pure BU-LRIC methodology, with a narrow definition of the increment.

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.

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 observes that FTRs set at an efficient level i.e. based on 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. As a result, a pure BU-LRIC approach is better suited to meet the requirement to promote efficiency set out in Article 13(2) of the Access Directive. 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 considers that BNetzA did not provide convincing justification why the chosen LRAIC+ approach would meet the objectives set out in Article 8 of the Framework Directive.

The Commission also observes that although the 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 observes that in the cost model BNetzA derives OPEX from DT's data adjusted for efficiency. But, in order to promote efficiency, the starting point of any reconciliation exercise should be a model of a hypothetical efficient operator and not DT's data as in BNetzA's chosen approach. The purpose of this reconciliation is to identify the sources of differences between both models, to quantify those differences and to make appropriate adjustments accordingly, thus assisting in the verification of the pure BU-LRIC model. Given the absence of pure BU-LRIC modelling for OPEX, it is difficult to assess to what extent the proposed adjustments have been sufficient to address DT's potential inefficiencies.

The Commission consequently considers that Articles 8(4) of the Framework Directive and Article 13(2) of the Access 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.

The Commission is of the view that BNetzA's reasoning that the use of pure BU-LRIC for FTRs (instead of LRAIC+) would decrease the level of FTRs thus increasing the FTR-MTR price difference, does not take into consideration the downward impact of pure BU-LRIC on MTRs, which would lead to a reduction of payments from fixed to mobile operators, in particular when applying the recommended approach also for MTRs. When notifying the cost model for fixed termination rates of DT, BNetzA did not analyze net payments effects based on traffic flows nor did it calculate what the level of pure BU-LRIC based FTRs would be. Against this background, the Commission considers BNetzA's comparative pure BU-LRIC/LRAIC+ approach as limited.

Furthermore, the Commission does not agree with BNetzA's assertion that the difference between LRAIC+ based FTRs and pure BU-LRIC based FTRs would lead to waterbed effect.

While cuts in the termination rates may imply price restructuring at retail level, this does not necessarily translate into higher retail tariffs since. Aligning all termination fees at an efficient cost level gives incentives to operators to compete for subscribers, e.g. by launching new retail packages. New retail packages provide additional revenue opportunities for the fixed operators and ultimately greater product/service choice for its end-users.

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 and DE/2014/1642 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 cases DE/2013/1430[13], DE/2013/1460[14] and DE/2014/1642[15], in sections 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 - BEREC is of the view that BNetzA should have analyzed what a competitive outcome would look like, considered external effects and the recovery gap.

- Reconciliation of data – the starting point of reconciliation exercise should be a model of a hypothetical efficient operator and not DT's data as in BNetzA's chosen approach.

- 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 present 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, higher than the FTRs from other countries that have set tariffs based on the recommended pure BU-LRIC approach.

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[13] BoR (13)55 – BEREC opinion on Phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC: Case DE/2013/1430 – Call termination on individual public telephone networks provided at a fixed location (market 3) in Germany; 17.05.2013.

[14] 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/2013/1430 – Call termination on individual public telephone networks provided at a fixed location (market 3) in Germany; 01.08.2013

[15] 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; 22.10.2014

BEREC has already raised all the concerns above in case DE/2013/1430 and has reiterated them in cases DE/2013/1460 and DE/2014/1642. Therefore all relevant conclusions on case DE/2013/1430, DE/2013/1460 and DE/2014/1642 can also be drawn for the present case.

5. CONCLUSIONS

On the basis of the analysis set out in section 4 above, BEREC considers that the Commission's serious doubts are justified in that (i) BNetzA's proposed 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 FTR 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.

BEREC acknowledges that despite numerous previous calls and evidences, BNetzA continues to regulate FTRs in Germany at LRAIC+. In addition, in the light of the Commission's serious doubts and the argumentation above, BEREC recommends BNetzA to set the FTRs for all SMP operators in Germany at the level of pure BU-LRIC costs and at the earliest opportunity.