Body of European Regulators
for Electronic Communications

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BEREC Opinion on

Phase II investigation

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

Case DE/2017/1961

Market for wholesale call termination on individual public telephone networks provided at a fixed location (Market 1) in Germany

5 April 2017

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1. EXECUTIVE SUMMARY

On 23 January 2017 the Commission registered a notification by the German National Regulatory Authority, BNetzA, concerning the Market for wholesale call termination on individual public telephone networks provided at a fixed location.

With regard to fixed termination rates, as stated in DE/2016/1945 BNetzA first ran a cost model based on a 'pure' BU-LRIC approach in line with the Commission's 2009 Termination Rates Recommendation[1] (hereinafter: Recommendation or TRR). According to BNetzA the application of this model would lead to FTRs considerably below the current average of FTRs in the European Union (EU). Therefore, BNetzA proposed to adjust the approved rate by a benchmarking approach, referencing against those countries which also apply a pure BU-LRIC cost model. The adjusted rate, which BNetzA proposes to approve, is 0.1 €ct/min. This rate is over [redacted] times higher than the calculated pure BU-LRIC rate.

On 23 February 2017 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 has serious doubts that the benchmarking proposed in the current draft measure leads to termination rates corresponding to the costs of a hypothetical, efficient operator in Germany.

On the basis of the analysis set out in this Opinion, BEREC considers that the Commission's serious doubts are justified.

BEREC suggests that in order to comply with the Recommendation, as well as the Framework Directive and the Access Directive, BNetzA could set the FTRs at the calculated pure BU-LRIC level at the earliest convenience possible.

2. INTRODUCTION

On 23 January 2017 the Commission registered a notification by the German National Regulatory Authority, BNetzA, concerning the Market for wholesale call termination on individual public telephone networks provided at a fixed location. On 2 February 2017, the Commission sent a request for information (RFI) to BNetzA, and a response was received on 6 February 2017.

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 23 February 2017. 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.

[1] 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.

On 3 March 2017 the EWG sent a list of questions to BNetzA. Answers were received from BNetzA on 6 March 2017.

The EWG met on 9 March 2017 in The Hague. During this meeting the EWG held a videoconference call with BNetzA to gather further information and clarification in response to the questions sent the week before and to additional questions. 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 finalized on 28 March 2017 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 5 April 2017. This opinion is now issued by BEREC in accordance with Article 7a(3) of the Framework Directive.

3. BACKGROUND

Previous notifications

On 15 November 2016, the Commission registered (under the case number DE/2016/1939 and DE/2016/1940) a notification from BNetzA, concerning the fourth round reviews of the market for wholesale call termination and the market for call origination on the public telephone networks provided at a fixed location in Germany and on 17 November 2016 the Commission registered a related notification from BNetzA concerning the proposed regulatory remedies on operators having significant market power (SMP) on the above referred markets (DE/2016/1945 and DE/2016/1946, respectively).

Call termination

BNetzA included in the markets for call termination on individual fixed networks termination services over narrowband and broadband (DSL, cable, IP-based fibre loop, stationary radio-based solutions) connections transferred at PSTN level or at IP level, realised at the lowest possible interconnection level. Call termination to geographical telephone numbers, emergency calls, and 0(32) number ranges are included in the market definition.

The geographic scope of each termination market corresponds to the geographic coverage of the network concerned; the markets for call termination encompass all incoming traffic, irrespective of geographical location of the source of the originating traffic. BNetzA designated DT and a group of 78 alternative operators as having SMP in the market for wholesale voice call termination on their individual public telephone networks provided at a fixed location.

Under DE/2016/1945 BNetzA imposed on all SMP operators the following obligations: (i) to provide interconnection and call conveyance; (ii) to grant colocation and access to colocation facilities; (iii) to make sure that access agreements are based on objective criteria and transparency, and that such agreements grant equal access and meet the requirements of fairness and reasonableness; (iv) to submit to BNetzA agreements on access services and facilities to which they are parties as providers; (v) to publish a reference offer; and (vi) price control.

With regard to price control, BNetzA changed its previous costing methodology and decided to apply a so-called 'pure' BU-LRIC cost model for FTRs in line with the TRR.[2]

In line with its decision concerning mobile termination rates[3], BNetzA also excluded the termination of calls originating in non-EEA countries from the price regulation of FTRs.[4]

Current notification and the Commission's serious doubts

Current notification

The currently notified draft measure concerns the imposition of rates for call termination and call origination in the fixed network of DT for the period until 31 December 2018.[5]

Price caps for fixed call termination services

With regard to fixed termination rates, as stated in DE/2016/1945 BNetzA first ran a cost model based on a 'pure' BU-LRIC approach in line with the TRR.

According to BNetzA the application of this model would lead to FTRs of:

€ [redacted] ct/min.

However, in light of the fact that this level is considerably below the current average of FTRs in the European Union (EU), BNetzA proposed to adjust the approved rate by a benchmarking approach, referencing against those countries which also apply a pure BU-LRIC cost model. The adjusted rate, which BNetzA proposes to approve, is:

€ 0.1 ct/min.

As a result of this adjustment the proposed rates are set over [redacted] times higher than the rates calculated with BNetzA's own pure-LRIC model. BNetzA justifies this adjustment with the objective to harmonise termination rates at EU level and to reduce the difference between individual rates in the different Member States in order to contribute to the development of the internal market. BNetzA argues in its proposal that the TRR has the aim to achieve symmetric termination rates also across borders and to harmonise the level of the rates across the EU.

[2] This change in approach by BNetzA is also consistent with the recommendations by the Commission and opinions of BEREC in a number of previous cases.
[3] Case DE/2016/1887.
[4] However, in its draft measure BNetzA imposes a regulatory guarantee that the calls from such non-EEA countries can be made through a transit connection.
[5] In response to the Commission's request for information, BNetzA confirmed that the proposed rates for other fixed SMP operators are currently under national consultation with a view to be notified to the Commission in March 2017. The current proposal is that these rates are set at a level symmetric to that of DT.

Commission's serious doubts

The Commission has serious doubts as to whether the benchmarking proposed in the current draft measure leads to termination rates corresponding to the costs of a hypothetical, efficient operator in Germany. The Commission argues that BNetzA has not provided any reasonable justification setting out why a rate over [redacted] times higher than the calculated pure-LRIC rate would still reflect efficient costs for fixed termination services and, thus represent a valid approximation of the true "as-if-competition" price for fixed termination in Germany.

The Commission considers, at this stage, that BNetzA has not provided a sufficient justification as to why its regulatory decision should not be based immediately on its pure BU-LRIC model cost results, and as to why a considerably higher rate based on pure BU-LRIC rates in other Member States would reflect efficient costs for termination services in Germany and promote sustainable competition and consumer benefits.

4. ASSESSMENT OF THE SERIOUS DOUBTS

On 23 February 2017, 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. Commission's doubts concern compliance with the requirements referred to in 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, in particular:

The need to ensure that customers derive maximum benefits in terms of efficient cost-based termination rates and that fixed termination rates promote competition.

Concerns of the Commission

The Commission has serious doubts as to whether the benchmarking proposed in the current draft measure leads to termination rates consistent with a price in a hypothetically competitive German market.

The Commission points out that BNetzA has calculated such incremental avoidable costs through applying a pure-LRIC model for fixed call termination services in Germany. The Commission assumes at this stage that the calculated pure-LRIC rate is the most appropriate approximation of an "as-if-competition" price for the respective market in Germany and represents the cost which would be faced by an efficient operator providing the relevant service.

If there are indications that benchmarking leads, in a given situation, to outcomes inconsistent with those in a competitive market, benchmarking cannot be considered as a valid stand-alone methodology that meets the requirements in Article 13 (2) of the Access Directive.

The Commission considers, at this stage, that BNetzA has not provided a sufficient justification as to why its regulatory decision should not be based immediately on its pure BU-LRIC model cost results, and as to why a considerably higher rate based on pure BU-LRIC rates in other Member States would reflect efficient costs for termination services in Germany and promote sustainable competition, and consumer benefits.

Furthermore, the Commission points towards BEREC's response to the Commission's public consultation on the evaluation of the TRR. BEREC has stated that even if each country used exactly the same model to estimate the cost of termination services some variation of rates would still be expected. The scope for adjustments to a country-specific model in light of experience in other Member States is a legitimate subject for further in-depth consideration, including within BEREC. In this respect, the Commission does not subscribe to the assertion by BNetzA that the objective of the TRR was first and foremost a harmonisation of the rates rather than a harmonisation of the applied methodology.

Views of BNetzA

BNetzA explains that their decision to use a benchmark approach is based on the fixed-network interconnection regulatory order.[6] In this order they have referred to the TRR, Recital 2: "in determining the rates (…) the objective of a Union-wide harmonisation of procedures and results must be taken into account appropriately."

In the reasoning of the FTR regulatory order, BNetzA reserves the right to make a different calculation of the rates, in particular by means of a benchmark of what BNetza considered to be comparable markets, should the rates determined prove to be "outliers". BNetzA argues that the Commision has previously focused on harmonising the level of rates rather than the approach. Since the calculated pure LRIC rates are significantly lower than the EU average, BNetzA chooses to use a benchmark method instead, thereby ensuring a harmonisation of rates.

Furthermore, according to BNetzA, using a pure LRIC approach would lead to rates falling too steeply and no competitor has argued in favor of such a reduction in rates.

BEREC's Assessment

Based on its review of this case, BEREC believes that there are clear arguments against BNetzA's position of not applying the results of its pure BU-LRIC model.

Harmonisation

According to BNetzA, the objective of the Recommendation is not a harmonisation of methodology, but rather a harmonisation of results.

BEREC would like to point out that prior to the publication of the Recommendation the EC recognized a broad range of wholesale termination rates costing models applied across the European Union, which in their view could have only been partly explained by national circumstances. The EC perceived the divergences in the regulatory treatment of the fixed and mobile termination rates to create fundamental competitive distortions and so concluded that the "lack of harmonisation in the application of cost-accounting principles to termination markets to-date demonstrates a need for a common approach". Hence, the EC decided to adopt the Recommendation in order to provide greater legal certainty, the right incentives for potential investors, as well as to reduce the regulatory burden on existing operators and assure a level playing field for all electronic communication operators in the European Union.

Consequently, the Commission recommended that NRAs set symmetric termination rates between operators in a Calling Party Network Pays charging system at the most cost efficient

[6] Regulatory order BK 2b 16-005 of 19.12.2016

level. In the context of wholesale voice call termination markets, and given their competitive and distributional characteristics, the cost efficient rate was defined as the one resulting from a bottom-up modelling approach using a pure long-run incremental costs methodology (pure BU-LRIC). Moreover, given that voice call termination services are traffic-related services, setting the efficient cost for their provision on the basis of a pure BU-LRIC methodology implies that fixed termination rates should allow only for the recovery of those costs which vary with the level of termination traffic and that would be avoided if a wholesale voice call termination service were no longer provided to third parties.

It is important to stress that even if all Member States use the recommended model or even if each country used exactly the same model to estimate the cost of termination services, some variations in the actual rates would still be expected. Electronic communications networks in different countries have different topologies and are confronted with different geographical conditions. Additionally, different countries are likely to face different labour costs and different network dimensioning parameters. In fact, any cost modelling exercise will be dependent on a large number of individual input assumptions and dimensioning decisions, calibration exercises and even the timing of implementation and technology choices. These differences can lead to a divergence in outputs for any form of cost model including pure LRIC modelling, which is susceptible to differing assumptions. Therefore, it is reasonable for efficient networks in different countries to exhibit different LRIC levels and the outcome of a country specific BU-LRIC model will be more accurate than a rate based on a European benchmark.

Bearing in mind the aforementioned considerations, it is BEREC's understanding that the TRR's objective is to set out a consistent approach regarding price control obligations that NRAs should in principle follow and therefore, in other words, to harmonise the applied cost methodology. Furthermore, the application of a cost standard by an NRA based on an efficient operator, should also erase any asymmetries of termination rates (except for a difference between FTR and MTR) applied within Member States, that is, to promote symmetric rates between operators of a Member State. While it is likely to be expected that the consistent application of the same cost methodology would reduce differences in rates across Member States, even among Member States that have fully implemented the Recommendation, and even amongst those who have done it earlier than Germany, it is still possible to observe a range of different levels of FTRs and also MTRs.

Therefore, BEREC shares the Commission's opinion that the main objective of the TRR is not to level the rates across Member States but to harmonise the cost methodology and to promote symmetry within Member States.

Justification of using a benchmark instead of pure BULRIC

As expressed in point 12 of the TRR, methods other than the recommended pure BU-LRIC model such as benchmarking might, in exceptional circumstances, be a valid alternative methodology, where an NRA is not in a position, in particular due to limited resources, to finalise the recommended pure BU-LRIC model. This requires, however, that the NRA is able to demonstrate that the chosen methodology results in outcomes consistent with the TRR and those in a competitive market. It is clear that BNetzA is not in such a position, based simply on the fact that BNetzA was able to produce a rate based on the pure BU-LRIC cost model approach.

The Commission asked BNetzA for a summary of the reasons as to why they adapted the approved rates, and also asked what were the steps that BNetzA took, and why, to increase the approved tariffs above the results of the pure BU-LRIC cost model. According to BNetzA, “the result of the cost model was adjusted in order to take adequate account of the aim set out in the TRR to harmonise termination rates across the EU.” BNetzA elaborated by stating that if the result of the cost model had been applied, “then the termination rate in Germany would have been the lowest within the EU Member States” and that the current approved rate would have been reduced by [redacted] %. Furthermore, the majority of the competitors said in their responses (to BNetzA’s consultation) that they opposed such a “massive reduction in the rate”. According to BEREC, neither the notion that rates would fall steeply, nor such opposition by competitors provide a reasonable justification for not using the results of the pure BU-LRIC model. In this regard, and based on BEREC’s termination snapshots, it should be noted that when comparing the rate directly after the BU-LRIC model or benchmark based on pure LRIC rates was applied by other Member States (not considering Norway nor Iceland) with the previous rate, FTR’s in approximately 70% of these countries had a decrease of between 70% and 90%.

As stated by the Commission in its Serious Doubts letter, BNetzA does not explicitly question the reliability of the calculations of its model, but disregards the results for other reasons, namely the discrepancy with rates as calculated to date by other NRAs. BEREC fails to find any other explanation by BNetzA for their choice to deviate from their calculated pure BU-LRIC rate.

It should also be noted that in accordance with the TRR, NRAs should have ensured that termination rates were implemented, amongst other things, at a symmetric cost efficient level, that is, with a pure BU-LRIC methodology, as of 31 December 2012. BNetzA had, therefore, more than four years since the deadline to apply the Recommendation. Article 19(2) of the Framework Directive provides NRAs the possibility not to follow a recommendation, but in such circumstances they have to provide reasons for such deviation, which BNetzA, as seen in past Phase II procedures, in both the Comission and BEREC’s view, has not been able to present. At the same time, any alternative regulatory approach chosen by the NRA other than the one recommended by the Commission has, according to the Article 19 of the Framework Directive, to comply with the other provisions of this Directive and, in particular, with Articles 8(4) and 13(2) of the Access Directive in conjunction with Article 8 and 16(4) of the Framework Directive. BEREC is also of the view that the alternative aproach presented by BNetzA does not comply with said provisions.

5. CONCLUSIONS

On the basis of the analysis set out in section 4 above, BEREC considers that the Commission's serious doubts regarding the draft decision of the German National Regulatory Authority on the need to ensure that customers derive maximum benefits in terms of efficient cost-based termination rates and that fixed termination rates promote competition are justified.

BEREC is of the opinion that BNetzA has not provided sufficient nor reasonable justification for not using the pure BU-LRIC approach. BEREC agrees with the Commission that the TRR should lead to a harmonisation of approaches rather than a harmonisation of rates. Furthermore, BEREC finds that the use of a benchmark was not justified in this case, given the requirements as stated in the TRR. BNetzA suggests that the reduction of the FTR would be too strong with the adoption of pure BU-LRIC, but BEREC shows that this reduction is in line with reductions in other Member States. Lastly, BNetzA has had more than four years since the deadline to implement the recommended methodology, but it has not presented reasons to deviate from the TRR.

In light of the Commission's serious doubts and the argumentation above, BEREC suggests that in order to comply with the Recommendation, as well as the Framework Directive and the Access Directive, BNetzA could set the FTRs at the calculated pure BU-LRIC level at the earliest convenience possible.