Body of European Regulators
for Electronic Communications

BEREC

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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/2017/1997

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

17 August 2017

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1. Executive summary

On 9 June 2017, the Commission registered a notification by the German National Regulatory Authority, *Bundesnetzagentur* (BNetzA), concerning the Market for wholesale call termination on individual public telephone networks provided at a fixed location, in particular the setting of the level of rates for 74 alternative operators.

With regard to fixed termination rates, as first 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] ('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, as set out in DE/2017/1961, which BNetzA proposes to approve, is 0.10 €ct/min. This rate is several times higher (approximately [redacted] times higher) than that estimated using the pure BU-LRIC methodology.

On 7 July 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 can lead to an outcome that is consistent with a price in a hypothetically competitive German market. Even though the outcome of the benchmarking approach chosen by BNetzA does not exceed the average of the termination rates set by those NRAs implementing the recommended cost methodology, the Commission has serious doubts that the benchmarking price of 0.10 €ct/min represents a reasonable and appropriate approximation of the costs of the provision of the fixed termination services in Germany, in particular given that the German NRA has calculated itself on the basis of a pure BU-LRIC model such an "as-if-competitive" price of [redacted] €ct/min.

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 9 June 2017, the Commission registered a notification by the German National Regulatory Authority, BNetzA, concerning the Market for wholesale call termination on individual public

[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.67-74.

telephone networks provided at a fixed location. On 20 June 2017, the Commission sent a request for information[2] to BNetzA and a response was received on 23 June 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 sent to BNetzA on 7 July 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.

Based on their reading of the serious doubts letter and related material, the EWG chose not to request further information from BNetzA.

The EWG held a virtual meeting at *Vidyo*, provided by the BEREC Office, on 17 July 2017. It was agreed by the EWG that there was no requirement for an audition with BNetzA to gather further information or clarification on outstanding issues. Additionally, nor did BNetzA request such an audition to provide any further information or clarification. The objective of the EWG was to reach clear conclusions on whether or not the Commission's serious doubts are justified. Furthermore, no call was held between the EWG and the Commission on this occasion. Given the clear similarities between the current case and DE/2017/1961, the EWG uses much the same argumentation in this Opinion as was used in the Opinion for DE/2017/1961.

A draft Opinion was finalized on 9 August 2017 and a final Opinion was presented to, and adopted by, a majority of the BEREC Board of Regulators on 17 August 2017. This Opinion is now issued by BEREC in accordance with Article 7a(3) of the Framework Directive.

3. Background

Previous notifications

Subsequent to BNetzA notifying its fourth round review of the market for wholesale call termination on the public telephone networks provided at a fixed location in Germany, and the proposed regulatory remedies on operators having significant market power (SMP) on that market, BNetzA, on 23 January 2017, notified its decision approving the specific price level for voice call termination services in the network of DT (DE/2017/1961).

On 23 February 2017 the Commission opened an in-depth investigation concerning the price setting decision, expressing the view that BNetzA had not provided sufficient justification as to why it considered that the pure BU-LRIC model does not adequately reflect the efficient costs of voice call termination services in Germany. On 5 April 2017, BEREC issued its Opinion considering the Commission's serious doubts as fully justified and suggested that BNetzA should set the FTRs at the calculated pure BU-LRIC level as soon as possible. On 23 June 2017 the Commission issued a Recommendation pursuant to Article 7a of the Framework Directive, thus concluding the Phase 2 investigation, and required BNetzA to adopt pure BU-LRIC rates.

[2] In accordance with Article 5(2) of the Framework Directive.

Current notification and the Commission's serious doubts

Current notification

The currently notified draft measures concern the imposition of rates for voice call termination services in the fixed networks of 74 operators designated as having SMP, for the period 1 January 2017 until 31 December 2018.

In order to ensure symmetry of rates at the national level, BNetzA proposed to set the FTRs for those operators equal to the rate set for the incumbent DT (DE/2017/1961). BNetzA proposed to set the same symmetric FTRs, regardless of the method and technology of interconnection. BNetzA proposed to approve the FTRs at the amount of 0.10 €ct/min, which is several times higher (approximately [redacted] times higher) than that estimated using the pure BU-LRIC methodology ([redacted] €ct/min).

This results from the adjustment of the rate as approved for DT in case DE/2017/1961, which BNetzA justified 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 also in its current proposal that the Commission's 2009 Termination Rates Recommendation has the aim to achieve symmetric termination rates not just within a jurisdiction but also across borders in order to harmonise the level of the rates across the EU.

Commission's serious doubts

The Commission has serious doubts as to the compatibility with EU law of BNetzA's draft measures concerning price control remedies for the market for call termination on individual public telephone networks provided at a fixed location in Germany in its current form, in particular 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.

On the basis of the notification and the additional information provided by BNetzA, the Commission has serious doubts with respect to the need to ensure that customers derive maximum benefits in terms of efficient cost-based termination rates and that fixed termination rates promote competition.

The Commission points to the fact that for the period until 31 December 2018 BNetzA intends to implement price caps for the fixed termination rates of the relevant SMP operators using as a benchmark the rates approved for DT, which in turn are set as the average of the rates in those Member States which apply a pure-LRIC model, despite the fact that BNetzA itself has developed its own pure-LRIC model and has calculated the incremental costs for fixed termination based on this model.

The Commission has serious doubts that the benchmarking proposed in BNetzA's current draft measure can lead to an outcome that is consistent with a price in a hypothetically competitive German market. Even though the outcome of the benchmarking approach chosen by BNetzA does not exceed the average of the termination rates set by those NRAs implementing the recommended cost methodology, the Commission has serious doubts that the benchmarking price of 0.10 €ct/min represents a reasonable and appropriate approximation of the costs of the provision of the fixed termination services in Germany, in particular given that BNetzA has itself calculated, on the basis of a pure BU-LRIC model, such an "as-if-competitive" price of [redacted] €ct/min.

The Commission is of the view that BNetzA did not provide sufficient justification why it chose not to follow the Recommendation and, in particular, why the chosen benchmarking approach would best meet the objective of consistent regulatory practice and the consistent application of the Regulatory Framework as set out in Article 8(3)(d) of the Framework Directive.

Furthermore, BNetzA did not present sufficient evidence that the benchmarking methodology setting the proposed FTRs would achieve the policy objectives of Article 8(2) and (4) of the Framework Directive, as it may lead to competitive distortions between operators. In particular, the proposed measure, if adopted, would allow the operators to charge termination fees significantly above their costs, and ultimately, lead to the application of consumer tariffs, which are based on wholesale inputs above avoidable costs.

4. Assessment of the serious doubts

On 7 July 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'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.

In the context of wholesale voice call termination markets, and given their characteristics, the Commission points out that the cost efficient rate is normally the one resulting from a pure BU-LRIC methodology and that BNetzA has calculated such incremental avoidable costs through applying a pure BU-LRIC model for fixed call termination services in Germany. In that sense, and considering that BNetzA has not suggested that its model is flawed, at this stage the Commission has to assume that the pure BU-LRIC model rate calculated by BNetzA is the most appropriate approximation of an "as-if-competition" price for the respective market in Germany and represents the cost that 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 the rates approved for DT

(DE/2017/1961), which in turn are set as the average of pure BU-LRIC rates in other EEA countries, 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 states that in order to ensure symmetry of rates at the national level, FTRs for the 74 smaller operators designated as having SMP shall be set equal to the rate set for the incumbent operator, DT (DE/2017/1961), regardless of the method and technology of interconnection.

In its reasoning, BNetzA justified the right to make a different calculation of the rates, in particular by means of a benchmark, 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 also argues that the Commission's 2009 Termination Rates Recommendation has the aim to achieve symmetric termination rates not just within a jurisdiction but also across borders in order to harmonise the level of the rates across the EU. 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.

BEREC's Assessment

Based on its review of this case, and considering its close relation to the previous BEREC Opinion regarding the phase II investigation on the case DE/2017/1961, 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 approaches concerning termination rates costing models, but rather a harmonisation of the level of such rates.

BEREC would like to point out that prior to the publication of the Recommendation the Commission 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 Commission 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 Commission 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 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.

As previously mentioned and pointed out by the Commission, 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, in general, likely to face different 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 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 FTRs and MTRs) 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 BU-LRIC

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.

Also noteworthy is that in the previous phase II case, DE/2017/1961, 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 significantly 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". BEREC reaffirms that 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, FTRs 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.

BEREC also notes that BNetzA's intended approach introduces a risk of upward bias into the setting of termination rates. The benchmark is set as the average of the rates in those EEA countries which apply a pure-LRIC model. If a Member State finds that its cost modelling generates rates lower than the ones calculated by other Member States and responds by adopting a benchmark set in this way, then in time the set of rates included in the benchmark average will increasingly be composed of rates which, at the date of their adoption, were at or higher than the prevailing pure-LRIC-based rates. It is less likely that a Member State will adopt the benchmarking approach if its cost model generates higher rates than the benchmark average, because to do so would mean requiring operators to charge less than the cost to them of providing termination, as estimated by the NRA's cost model. The risk of upward bias would be greater if other Member States were also to adopt this approach.

Aside from this risk of upward bias, the practice of reflecting previous cost-modelling-based estimates via benchmarking to determine new rates is inherently backward-looking. To the extent that termination costs are expected to decline over time, the benchmarking approach will tend to delay this reduction in costs being reflected in lower rates, compared to an approach where each Member State, as far as possible, carries out its own cost modelling.

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, according to the Article 19 of the Framework Directive, has 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, BNetzA, 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 believes that there are two clear arguments against BNetzA's position of not applying the results of its pure BU-LRIC model, namely the harmonisation of cost methodologies and the promotion of symmetry within Member States, and a lack of sufficient or reasonable justification for using a benchmark instead of pure BU-LRIC. In addition, BNetzA has had more than four years 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 presented in this Opinion, 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.