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Annex to survey: https://bo-survey.berec.europa.eu/eusurvey/runner/B-Services-PC

Public consultation on the draft BEREC Report on regulatory treatment of business services, BoR (22) 185

Dear Madam, Dear Sir,

1&1 appreciates the opportunity to comment on BEREC's Draft Report on regulatory treatment of business services. Competitive problems regarding B2B electronic communications services remain a relevant issue particularly in the German market, with the incumbent continuing to hold large retail market shares for an extended time. Given that these services are ultimately used by SMEs and start-up businesses, their regulatory treatment have important ramifications on the backbone of the EU economy.

In this regard, the Draft Report raises unresolved questions which 1&1 seeks to address in this response. 1&1 has aligned our comments to the numerical order of the chapters in the Draft Report, which should facilitate the processing of the responses.

Chapter 10 – Conclusions

Vague objective and insufficient evaluation

Regrettably, the conclusion is merely descriptive and just an aggregated summary of questionnaire responses of the surveyed NRAs. At this stage, the purpose of BEREC's data collection is hard to interpret. BEREC should include a section on whether and how it will utilise the main Draft Report findings.

For example, BEREC concludes that retail markets for business services remain highly concentrated in most surveyed countries. According to BEREC's commissioned Study, Deutsche Telekom (hereinafter: "Telekom") has very high market shares for retail business services, both in absolute and relative terms.[1] This is aggravated by the fact that between 2018[2] and 2022 Telekom was able to reclaim 12 percentage points of market shares from its

[1] Study on Communication Services for Businesses in Europe: Status Quo and Future Trends, Final Report December 2022, BoR (22) 184, Table 5.5 on page 42.
[2] i.e. Telekom's wholesale B2B product launch.

competitors in retail business services (based on revenues).[3] However, BEREC does not elaborate on what its next steps will be to address this persistent market failure.

Similarly, the conclusion only contains a short reference observing that traditional leased lines are increasingly being substituted by Ethernet leased lines, and that some NRAs are overseeing the smooth transition as part of the incumbent's announcement of a migration plan. However, the Draft Report does not further evaluate to what extend the interests of access seeking competitors are protected and by whom the costs of migration should be borne.

Additionally, while the Draft Report only describes which types of wholesale price regulation were adopted by various NRAs, it does not further evaluate whether wholesale price regulation has achieved its intended purpose or whether it actually proved counterproductive, leading to competitive distortions.

A further point of concern is that a substantial part of the preparatory work leading up to the publication of this Draft Report – particularly the corresponding Workshop held on 4 October 2002 – is not reflected in this Report. 1&1 is a member of the association ecta. As part of ecta's active participation in the Workshop, 1&1 had made significant contributions to ecta's presentation and slides, calling specific attention to the shortfalls of wholesale business services regulation in Germany. Hence it is disappointing to find that ecta's contribution is in no way reflected in the Draft Report.

Insofar as BEREC intends to use these findings to prepare BEREC Guidelines to further harmonise the NRAs' approaches to delineate Market 2/2020 and their selection of remedies, the collected data may not be entirely complete in achieving these objectives. Accordingly, 1&1 will address the shortfalls of German wholesale business services regulation in the next section of this response.

Chapter 11 – Future Work

Going forward, BEREC intends to explore in more depth *inter alia* the evolution of competition dynamics among different market actors and its relation to country-specific characteristics (such as business models and regulation applied) with the aim of identifying good practices to be shared amongst all NRAs.

In the light of these aims, BEREC should critically examine the following four shortfalls in the German regulatory landscape of business services. Each of these regulatory deficits are deserving of an in-depth analysis by BEREC:

1. **Regulatory loopholes have solidified Telekom's retail market power (2018-2022)**
2. **Devaluation of competitors' infrastructure**
3. **Migration costs**
4. **Faulty cost analysis in margin squeeze test**

[3] Based on internal 1&1 analysis with refence to VATM Market Studies 2018-2022, available at: https://www.vatm.de/marktstudien/ (last retrieved on 03.02.23).

Ecta had already provided input for each of these topics during BEREC's workshop on 4 October 2022. In line with this, we are bringing those four regulatory topics to your attention.

1. Regulatory loopholes have solidified Telekom's retail market power (2018-2022)

Specific weaknesses in the German regulatory framework have been pivotal to Telekom's ability to regain market shares – both in non-regulated/commercial and regulated segments within the business market – and thus to solidify its market power for retail business services from 2018 onwards.

In providing context to the issue at hand, in 2018 Telekom has been held to have SMP in former Market 4/2014 for leased line segments with bandwidths from 2 Mibit/s to 155Mbit/s.[4] BNetzA's corresponding regulatory remedy is *ex post* in nature and prescribes that wholesale prices for active access services to the relevant bandwidths ("VPN 2.0") are subject to a pricing transparency obligation. As an SMP operator Telekom must therefore notify its wholesale prices for the leased line segments 2 Mibit/s-155Mbit/s to BNetzA. Such adopted prices are legally enforceable and are not dependant on prior authorisation of BNetzA. If, however, BNetzA concludes that the notified prices are abusive, it can initiate proceedings and make a finding of abuse, so-called "ex post control" by BNetzA which is a national peculiarity in German sector-specific telecoms regulation. Only after such a finding of abuse is Telekom no longer permitted to charge and enforce the said wholesale prices. Importantly, the *finding of abuse does not apply retroactively*, meaning all wholesale prices charged until then remain legally enforceable to the benefit of Telekom.

As part of BNetzA's ex post control, it made a finding on 31 May 2022 that Telekom's wholesale prices for the regulated leased lines were in fact abusively high.[5] In turn, Telekom was able to charge and *legally enforce* what were essentially abusive wholesale prices from Q4 2018 - Q2 2022, i.e. for more than three years. This is because a finding of abusive cannot apply retroactively, as already mentioned. Hence Telekom has had no legal and economic incentives to end its abusive wholesale pricing strategy during BNetzA's ex post investigations. This is aggravated by the fact that BNetzA's sector-specific ex post control is *not bolstered by penal measures*.[6] By contrast, the imposition of fines is integral to the public enforcement of competition law.[7] As such, Telekom did not have to fear sanctions from BNetzA for its abusive conduct.

During the relevant period of Q4 2018 - Q2 2022, market shares for retail business services (based on revenue) has shifted from competitors to Telekom by 12 percentage points.[8] This coincides with Telekom's abusive pricing which – owed to the loopholes in the German regulatory framework described above – only came to an in Q2 2022 after a belated intervention by BNetzA. Hence there is a strong correlation between the regulatory deficiencies on the wholesale level and Telekom's ability to reclaim its retail market shares, thereby solidifying its retail market power.

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[4] BNetzA decision from 19.12.2018, BK2a-16/002.
[5] Nb: 1&1 had already brought that specific pricing abuse to BNetzA's attention in Q2/2019.
[6] See, by implication, § 228 of the German Telecommunications Act ("TKG").
[7] For example, the European Commission and NCAs may impose fines of up to 10 % of the undertaking's total turnover in the preceding business year for intentional or negligent infringement of Art.101/102 TFEU and national equivalents: Art. 23(2) Regulation 1/2003; see also §81c (2) of the German Act against Competitive Restraints ("GWB").
[8] Based on internal 1&1 analysis with refence to VATM Market Studies 2018-2022.

2. Devaluation of competitors' infrastructure

Wholesale price regulation should not lead to the devaluation of the competitors' infrastructure. Pricing of wholesale active services should appropriately reflect the differences in the value chain. The ladder of investment should not be skewed as to disadvantage access seekers with their own core network (hereinafter: *carriers*) over resellers. Only the sustainability of the carrier business model effectively contributes to infrastructure competition for the benefit of business customers, a core objective of the EECC.[9]

As mentioned above, BNetzA made an ex post finding on 31 May 2022 that Telekom's wholesale tariffs for the regulated leased lines were in fact abusively high. All wholesale prices charged from 31 May 2022 onwards are no longer enforceable. Consequently, on 17 August 2022 BNetzA prescribed lower wholesale tariffs from 31 May 2022 onwards.[10]

Yet, BNetzA's recent reduction of prices for the relevant actively managed wholesale services have adverse consequences for infrastructure competition. In particular, the reduction of wholesale prices accelerates the devaluation of carriers' infrastructure and hence the end of infrastructure competition in the long term. This is because the current wholesale pricing for the relevant leased lines discriminates against carriers with their own infrastructure compared to competitors without such an infrastructure, who only operate as resellers.

There is demand for active wholesale products on different stages of the value-creation chain. In essence, Telekom's active wholesale services consist of (1) access to business customers and (2) transport service via Telekom's core network.

Carriers purchase "infrastructure-near" wholesale products, consisting of only (1) access to business customers, while carrying out its in-house transport service via its own core network. By contrast, resellers purchase "infrastructure-distant" wholesale products, consisting of both (1) access to business customers and (2) transport service via Telekom's core network, since they do not own infrastructure themselves. Hence two different types of business models can be made based on Telekom's active wholesale services (so-called "make or buy" decision).

Using their own core network is an essential requirement for carriers to offer their own innovative business services that can compete with the incumbent's business product (e.g. Telekom's EC 2.0). Business customers demand services and applications based purely on the provision of leased lines, such as the prioritisation of certain voice traffic over Internet traffic, high-bit-rate Internet access, firewalls and other high-quality security applications (e.g. encryption), and back-up solutions based on the carrier's own infrastructure. By routing the leased connection points via their own core network, carriers gain more freedom in product design and quality, thereby enhancing the active wholesale leased line service with additional performance features as demanded by business customers. For example, the use of the carrier's own core network can better solve network congestion and minimise performance complications such as latency, jitter and packet loss. By contrast, resellers are unable to add such value to their product offering.

However, BNetzA's finding of abusive prices on 31 May 2022 and the corresponding decision of lower pricing henceforth has led to an unsatisfactory result. In particular, BNetzA has drastically miscalculated the price component for (2) transport service via Telekom's core

[9] Art. 3(2) lit (b) EECC.
[10] BNetzA decision from 17.08.22, BK2-22/007.

network and set a far too low price level. In turn, this leads efficient competitors to only make a "buy" decision and hence only adopt a reseller business model instead of the infrastructure-based carrier business model. This has completely distorted the ladder of investment by devaluing the infrastructure of Telekom's competitors.

As part of prescribing lower wholesale prices from 31 May 2022 onwards, BNetzA should have critically evaluated whether the corrected pricing structure ultimately favours resellers without infrastructure investments over competitors with their own carrier network. In particular, BNetzA should have assessed a cost-cost squeeze, i.e. whether the price span between the respective stages of value-creation (i.e. purchase of infrastructure-near wholesale product (1), vis-à-vis purchase of infrastructure-distant product (1) and (2)) is sufficient so that investments are worthwhile and that the higher entrepreneurial risk of the infrastructure-based business model is adequately taken into account. This is the only way that the infrastructure competition anchored in the EECC can be protected effectively and sustainably.

By omitting to consider this decisive infrastructure-based demand generated from the carrier business model, BNetzA's current tariffs correction forces all competitors into the role of mere resellers and thus massively curtails their opportunity to compete with Telekom in terms of quality. In practice, this technically amounts to a ban on value creation to the detriment of carriers. This contrasts sharply with the core objective of the EECC to promote competition in the field of telecommunications and efficient telecommunications infrastructures, particularly to promote efficient infrastructure-based competition.[11]

3. Migration costs

The Draft Report observes that traditional leased lines are increasingly being substituted by Ethernet leased lines. This is also true in Germany with regards to Telekom's announcement of its SDH switch-off. Costs associated with migrating from SDH to an equivalent product should be borne by Telekom, since Telekom has caused the migration process.

The costs of the migration to the equivalent product are to be borne by Telekom in full. Telekom has opted for the migration and the shutdown of its SDH network. It is therefore the sole cause of the costs arising from the migration. It not only has to bear the costs of provision, but also project planning costs, sunk costs and costs incurred by the business customer.

In addition, Telekom must pay for stranded investments. Due to the migration caused by Telekom, legacy product services are often migrated before the end of the term that would be required to comply with the business case, so that business customer projects based on said legacy services are no longer economically viable. In addition, competitors incur additional costs compared to the original calculation, e.g. through the planning of an additional shutdown and provisioning process.

Likewise, expenses arising from changes to existing, fully functional in-house cabling are to be borne by Telekom. Since the SDH switch-off and the resulting technology change require work on an intact cabling, the associated costs should neither be borne by business customers nor wholesale access seekers/competitors.

[11] Art. 3(2) lit (b) EECC.

Internal expenses of wholesale access seekers such as costs due to separate project management, which have arisen from Telekom's initiated migration, are also to be borne by Telekom.

4. Faulty cost analysis in margin squeeze test

NRAs should correct their assessment of margin squeezes and adopt a more differentiated evaluation of wholesale costs for efficient access seekers/competitors, instead of utilising averages for wholesale prices. Oftentimes, this is the only way that a margin squeeze can actually be detected.

A margin squeeze is intensified by the fact that the incumbent, such as Telekom, applies nationwide and uniform retail prices for its business services ("Ethernet Connect 2.0" – EC 2.0), while for the corresponding active VPN 2.0 wholesale service the access seeker is charged wholesale prices that vary by region.

While regionally varied wholesale pricing and uniform retail pricing is also evident e.g. in FTTH mass market, far more quantities of connections are sold in mass markets and hence the use of average prices is sensible. In particular, NRAs like BNetzA conduct a shopping cart analysis in which the average of all tariffs is formed. By contrast, business services do not have the volumes of sales compared to a mass market but are instead based on individual solutions. Therefore, a shopping cart analysis is not suitable in this case and a margin squeeze test calls for a more granular assessment of wholesale prices.

Instead of considering regionally varied wholesale service tariffs, a margin squeeze test with average values for wholesale prices ignores the fact that there are efficient competitors with completely different levels of expansion of their own networks. Some competitors may request "short range" lines, while others are dependent on requesting large quantities of "country region" lines, where a margin squeeze is particularly evident. These differing manifestations of a margin squeeze therefore have different magnitudes on various efficient consumers. These magnitudes can only be captured by a margin squeeze test if it also takes into account the different constellations on the demand-side at the wholesale level. A regionally differentiated wholesale price structure compared to nationwide and uniform retail prices intensify the price-cost gap considerably for affected access seekers.

Yours faithfully,

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