Body of European Regulators for Electronic Communications

BEREC

BEREC Opinion on

Phase II investigation

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

Case EE/2014/1572

The market for call termination on individual public telephone networks provided at a fixed location (Market 3) in Estonia

22 May 2014

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1. EXECUTIVE SUMMARY

On 7 March 2014, the Commission registered a notification by the Estonian Regulatory Authority, Estonian Competition Authority (ECA), concerning the market for call termination on individual public telephone networks provided at a fixed location.

With regards to the price control obligation, ECA proposes to move away from the currently applied TD HCA FDC cost model regime. ECA proposes to introduce a pure BU-LRIC FTR by 1 January 2016 based on a benchmarked approach. ECA finds it proportionate to provide a transitory period before implementing this particular benchmark by imposing reasonable and appropriate prices in the period between 1 July 2014 - 31 December 2015.

On 7 April 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. Commission's doubts concern compliance with Articles 8(4) and 13(2) of the Access Directive and Article 16(4) of the Framework Directive, in particular the need for an appropriate price control ensuring that customers derive maximum benefits in terms of efficient cost-based termination rates and concern Article 8(2) and (3) of the Framework Directive, in particular the creation of a considerable barrier to the single market.

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

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

2. INTRODUCTION

On 7 March 2014, the Commission registered a notification by the Estonian Regulatory Authority, Estonian Competition Authority (ECA), concerning the market for call termination on individual public telephone networks provided at a fixed location. On 17 March 2014, a request for information (RFI) was sent to ECA, and a response was received on 24 March 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 7 April 2014. In accordance with the BEREC rules of procedure an 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.

On 14 April 2014 the EWG sent its initial list of questions to ECA. Answers were received from ECA on 21 April 2014.

The EWG then met with ECA on 23 April in The Hague. During this meeting the EWG gathered further information and clarification on its initial queries.

A draft opinion was finalized on 15 May 2014 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 22 May 2014. This opinion is now issued by BEREC in accordance with Article 7a(3) of the Framework Directive.

3. BACKGROUND

Previous notifications

The market for call termination on individual public telephone networks provided at a fixed location in Estonia was previously notified to and assessed by the Commission under case EE/2010/10401. ECA defined the market as national in scope and identified ten operators with SMP.

Current notification and the Commission's serious doubts

Similarly to its first round market review (EE/2010/10401), ECA proposed to impose remedies on Elion (the incumbent) and on ANOs.[2] The regulatory obligations include: i) access, ii) non-discrimination, iii) transparency (including the publication of a reference offer), and iv) price control and cost accounting as well as (v) accounting separation.

With regards to the price control obligation, ECA proposes to move away from the currently applied TD HCA FDC cost model regime. Instead, ECA proposes to introduce a pure BU-LRIC FTR based on a benchmark. However, since the current benchmark, as calculated by ECA would result in a drop in FTRs of about 91%, from the current national level of 1.14 €cents /minute to 0.107 €cents/minute, ECA finds it proportionate to bridge the limit by instead imposing reasonable and appropriate prices in the period between 1 July 2014 - 31 December 2015.

The Commission has serious doubts that an extensive transitory period will help to promote efficiency and sustainable competition while maximising consumer benefits and promoting the interests of EU citizens. The Commission concludes that the price difference would be incurred at the expense of the operators, and eventually consumers, in the Member States from where the calls originate. The Commission therefore considers that the draft measure would create barriers to the internal market.

4. ASSESSMENT OF THE SERIOUS DOUBTS

On 7 April 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

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[2] Elion Enterprises AS (Elion), Elisa Eesti AS (Elisa), Televõrgu AS (Televõrgu), OÜ Eleks Telefon (Eleks Telefon), Linxtelecom Estonia OÜ (Linxtelecom), ProGroup Holding OÜ (ProGroup Holding), Riigi Infokommunikatsiooni Sihtasutus (RIKS), OÜ Top Connect (Top Connect), AS Starman (Starman), AS STV (STV).

2009/140/EC. Commission's doubts concern compliance with Articles 8(4) and 13(2) of the Access Directive and Article 16(4) of the Framework Directive, in particular the need for an appropriate price control ensuring that customers derive maximum benefits in terms of efficient cost-based termination rates and concern Article 8(2) and (3) of the Framework Directive, in particular the creation of a considerable barrier to the single market.

4.1 Need for an appropriate price control ensuring that customers derive maximum benefits in terms of efficient cost-based termination rates

Appropriate costing methodology

Concerns of the Commission

The Commission observed that the costing methodology proposed in ECA's draft measure for the period of 1 July 2014 – 31 December 2015 does not appear to comply with the principles and objectives set out in the Regulatory Framework.

ECA's position

ECA explained that an immediate application of pure BU-LRIC rates would lead to a sharp decline in the price of call termination. The effect analysis carried out by ECA showed that a shift to pure BU-LRIC rates from the currently imposed FTR based on TD HC FCD would result in a 91% drop in FTRs for the SMP operators. ECA also considered communications operator investments according to the Access Directive, Article 13(1) and (52) of the ESS[3] whereby the SMP operator should be able to earn a reasonable profit on adequate capital, and hence proposed a transitory period between 1 July 2014 – 31 December 2015.

BEREC opinion

BEREC agrees with the Commission's serious doubts. The cost methodology presented by ECA for the transitory period between 1 July 2014 – 31 December 2015 is not in line with the principles and objectives set out in the Regulatory Framework, especially the Recommendation on termination rates, and therefore the Commission's serious doubts in this regard are justified. On the basis of Article 19(2) of the Framework Directive NRAs have the possibility not to follow a recommendation. Where a national regulatory authority chooses not to follow a recommendation, it shall inform the Commission giving the reasoning for its position. According to BEREC, ECA has not provided sufficient reasoning to be able to deviate from the recommendation.

BEREC notes that the application of pure BU-LRIC rates might lead to a decline in the price of call termination, but the calculations presented by ECA showed that

i) the percentage of the fix call termination turnover from total turnover of the SMP-operators providing services on Market 3 in Estonia is 0,6 %, in 2012 and 2013 respectively, and
ii) the profit decrease due to the introduction of pure BU-LRIC would have amounted to minus 2.76 % in 2012, and minus 3.7 % in 2013.

These percentages do not appear to be particularly severe and thus may not jeopardise the business activities, e.g. investment capabilities of the SMP-operators. BEREC believes that a pure LRIC costing methodology is consistent with Article 13(1) of the Access Directive and may allow an undertaking to earn a reasonable rate of return on capital employed. BEREC would like to point out that the Estonian SMP-operators were able to reach reasonable profits in the previous years when they were able to charge termination rates calculated by ECA using TD HCA FCD cost model although ECA was urged by the Commission to reconsider its cost accounting methodology in its previous round of market review.

Justification of an additional 18 months transitory period

Concerns of the Commission

In the previous round of market review, notified under case EE/2010/1040, the Commission urged ECA to reconsider its cost accounting methodology and to align it with the recommended cost accounting principles of the Termination Rates Recommendation in its next round market review.

The Commission´s Recommendation on the regulatory Treatment of Fixed and Mobile Termination Rates in the EU was adopted in May 2009. The Commission recognized that a certain period of time was required for the transition to the relevant pure BU-LRIC cost model, and it considered that a transition period of three and a half years, until 31 December 2012, was sufficiently long, both for NRAs to put in place pure BU-LRIC models and for operators to adapt their business plans accordingly.

In the present case, ECA did not present sufficient evidence that an additional period of adjustment of 18 months is needed, i.e. 31 December 2015 instead of 1 July 2014 according to the Recommendation. Although the Commission understands that the impact on termination rates revenues would not be insignificant, the Commission believes that this is something that the Estonian operators have foreseen in light of what was communicated by ECA in relation to the former market review (case EE/2010/1040).

Furthermore, the Commission considers that Articles 8(4) of the Framework Directive – which requires NRAs to promote the interests of EU citizens - and Article 13(2) of the Access Directive — which requires NRAs to ensure that the chosen cost recovery mechanism serves to promote efficiency, sustainable competition and the maximization of consumer benefits — have not been adequately followed. In fact, the Commission has serious doubts that the request for an extensive transitory period of 18 months, in addition to the transitional period already foreseen in the Recommendation, will help to promote efficiency and sustainable competition while maximising consumer benefits and promoting the interests of EU citizens.

ECA's position

According to ECA a transitory period is needed in order to provide an opportunity for the SMP operators to prepare the implementation of call termination for their economic activities on 1 January 2016 using the pure BU-LRIC methodology.

ECA further justifies its proposal by stating that an immediate application of pure BU-LRIC rates would lead to a sharp decline in the price of call termination, which could be too cumbersome for SMP operators and would jeopardize their investment capabilities.

According to ECA it would be too burdensome for the operators if ECA would comply with the Recommendation as of 1 July, 2014, as it would result in heavily decreased fixed call termination revenues.

BEREC opinion

Considering that the Recommendation has been known to both NRAs and operators for 5 years, BEREC questions the ECA need for additional 18 months, until 31 December 2015, for transition to a pure BU-LRIC cost model.

In BEREC´s opinion, this is a development that the operators in Estonia should have been able to prepare since the Recommendation was adopted in 2009. Furthermore, ECA was already in the 2010 market review asked by the Commission to align with the Termination Rates Recommendation in its next round market review.

Even if such an extra time frame could be explained, BEREC supports the Commission´s view that ECA has not provided sufficient justification as to the reasons why this additional transitory period would be needed.

In order to comply with the Recommendation, as well as the Framework Directive and the Access Directive, BEREC would suggest ECA to set the FTRs at pure BU-LRIC level at the earliest convenience possible. The longer the operators in Estonia can continue to charge termination rates above the cost efficient rate, the longer it will take to achieve efficiency and sustainable competition in EU.

4.2 Creation of barriers to the internal market

Concerns of the Commission

The approach proposed by ECA results in a higher level of fixed termination rates than the average FTR in those six Member States which employ a pure BU-LRIC methodology. The Commission concludes that the price difference would be incurred at the expense of the operators, and eventually consumers, in the Member States from where the calls originate. Moreover, considerable asymmetries in fixed termination rates within the EU would 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. The Commission therefore considers that the draft measure would create barriers to the internal market.

BEREC's Assessment

BEREC has so far commented eight cases, where fixed termination rates have been set by alternative methodologies, than the one recommended by the Commission. In all cases, except the Latvian case (LV/2014/1538), BEREC has agreed with the Commission that the

draft measures set by the national regulators would have created barriers to the internal market.

BEREC notes that Estonia has the third smallest telecoms market in the EU and 1.3 million inhabitants. During the investigation, the Estonian Competition Authority provided information showing that 50% of the incoming international phone calls in Estonia are from the EU Member States. The total amount of calls from the EU is only 25 million minutes a year.

The approach proposed by ECA could create significant barriers to the internal market. However, taking into consideration the size of the Estonian fixed telephony market and the small share of international calls from the EU countries the impact of the draft decision on the internal market would be limited.

5. CONCLUSIONS

On the basis of the economic analysis set out in section 3 above, BEREC considers that the Commission's serious doubts regarding the draft decision of the Estonian Regulatory Authority on compliance with Articles 8(4) and 13(2) of the Access Directive and Article 16(4) of the Framework Directive, in particular the need for an appropriate price control ensuring that customers derive maximum benefits in terms of efficient cost-based termination rates and concern Article 8(2) and (3) of the Framework Directive, in particular the creation of a considerable barrier to the single market - as expressed in the EC's letter to ECA of 7 April 2014 – are mostly justified.

BEREC questions the ECA need for additional 18 months, until 31 December 2015, for transition to a pure BU-LRIC cost model. Even if such an extra time frame could be explained, BEREC supports the Commission´s view that ECA has not provided sufficient justification as to the reasons why this additional transitory period would be needed.

BEREC considers the barriers to the internal market created by the proposed measure of the ECA to be limited.

In the light of the Commission's serious doubts and the argumentation above, BEREC would recommend ECA, in order to comply with the Recommendation, as well as the Framework Directive and the Access Directive, to set the FTRs at pure BU-LRIC level at the earliest convenience possible. The longer the operators in Estonia can continue to charge termination rates above the cost efficient rate, the longer it will take to achieve efficiency and sustainable competition in EU.