Body of European Regulators for Electronic Communications

BEREC

BEREC Opinion

Phase II investigation

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

Case: FR/2012/1304: Wholesale market for voice call termination on individual mobile networks (market 7) – new entrants

Date: 23 May 2012

Content

1 Introduction

1. On 13 March 2012, the French NRA (Autorité de Régulation des Communications Electroniques et des Postes, ARCEP) presented to the European Commission (the Commission) a notification concerning the wholesale market for voice call termination on individual mobile networks (market 7) of three new entrant operators, i.e. Free Mobile, Lycamobile and Oméa Télécom (hereafter: the new entrants).

2. 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 13 April 2012.[1] 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.

3. According to Article 7a(3) BEREC shall, within 6 weeks and acting by a majority of its component members, issue an opinion on the Commission's serious doubts letter indicating whether it considers that the notified draft measure should be amended or withdrawn and, where appropriate, provide specific proposals to that end. This opinion shall be reasoned and made public. This opinion is given is in this document.

4. The EWG met on 25 April in The Hague. ARCEP also attended a part of that meeting to explain the case to the EWG and provide further information and clarification in response to questions. A draft opinion was finalized on 15 May 2012 and a final opinion was presented and adopted by a majority of the BEREC Board of Regulators on 23 May 2012. This opinion is now issued by BEREC in accordance with Article 7a(3) of the Framework Directive.

[1] https://circabc.europa.eu/faces/jsp/extension/wai/navigation/container.jsp?FormPrincipal:_idcl=FormPrincipal:_id3&FormPrincipal_SUBMIT=1&id=c7a508e0-0797-405f-b451-548773a1cdc4&javax.faces.ViewState=rO0ABXVyABNbTGphdmEubGFuZy5PYmplY3Q7kM5YnxBzKWwCAAB4cAAAAAN0AAIxMnB0ACsvanNwL2V4dGVuc2lvbi93YWkvbmF2aWdhdGlvbi9jb250YWluZXIuanNw.

2 Assessment of the serious doubts

5. ARCEP's notified decision imposes an asymmetric price cap for the MTRs of three mobile new entrants, of which one (Free Mobile) is a mobile network operator (MNO) and two (Lycamobile and Oméa Télécom) are mobile virtual network operators (MVNOs). The asymmetry means that these three new entrant operators have a higher MTR price cap than the other existing and regulated operators on the French market. The notified decision is intended to be applicable for the regulatory period from the date of implementation to 31 December 2013.

6. The asymmetry applied is based on two independent reasons, national roaming cost and traffic imbalance, that both are coupled to a certain amount of asymmetry that is applied.

7. The Commission expressed serious doubts as to the compatibility with the EU law of both surcharges for national roaming and traffic imbalance. The Commission considered that that the asymmetry is not adequately justified by higher incremental costs. The Commission particularly referred to the requirements of 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 also referred to the non-discrimination principle as set out in the Article 8(5) (b) of the Framework Directive.

2.1 Asymmetry based on national roaming cost

8. The first part of the asymmetry of the price caps in the notified decision is based on national roaming cost. According to ARCEP the incremental cost in roaming is the tariff that the new entrants have to pay to their hosts in order to terminate a call on one of their numbers

9. Article 8(4) of the Access Directive requires that the imposed obligations shall be based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in the Article 8 of the Framework Directive. ARCEP considers that the proposed asymmetry is justified and refers to the Commission's Recommendation 2009/396/EC of May 2009 on the regulatory treatment of fixed and mobile termination rates in the EU (hereafter: Recommendation). Point 10 of the Recommendation says: "In case it can be demonstrated that a new mobile entrant operating below the minimum efficient scale incurs higher per-unit incremental costs than the modelled operator, after having determined that there are impediments on the retail market to market entry and expansion, the NRAs may allow these higher costs to be recouped during a transitional period via regulated termination rates. Any such period should not exceed four years after market entry."

10. ARCEP concludes that there are impediments on the retail market to market entry and expansion, a conclusion that is not disputed by the Commission. ARCEP also concludes a new efficient generic

entrant is operating below the minimum efficient scale and incurs higher per-unit incremental costs than the modelled operator, if both *network* and *roaming cost* are considered. Regarding the efficient scale, ARCEP concludes this is smaller than the 20% market share mentioned by the Commission in the Recommendation (Recommendation p. 12).

11. Regarding the higher per unit incremental cost, ARCEP concludes the incremental cost of a *new* efficient generic network operator own's *network* is not higher than that of the efficient generic operators cost. However, ARCEP also concludes that the incremental *roaming rates* paid by a new entrant are a relevant factor in the total relevant costs that are concerned here. This is because ARCEP concludes that an new efficient generic entrant cannot roll out is it network nationwide directly and does not have a viable business case offering services on a sub national scale. Therefore, a new entrant needs roaming access on the networks of existing operators. ARCEP assesses the commercially negotiated incremental roaming rates of the three new entrants relevant in the notified decision. ARCEP determines from these negotiated incremental roaming rates the "most economically favourable conditions" for negotiated roaming. These are called the "efficient [incremental] costs for generic access to the network of a third-party operator". The latter rates are the efficient incremental roaming rates for the new efficient generic entrant. ARCEP determines from the factual negotiated incremental roaming rates of the three new entrants, that the efficient incremental roaming rates are above the incremental cost price of the efficient generic operator. The latter is the standard pure BULRIC cost price for an existing operator. Based on this ARCEP concludes that the requirements for the use of point 10 of the Recommendation are met and it is therefore appropriate to apply asymmetric caps on the current new entrants.

12. ARCEP then determines the amount of appropriate asymmetry (the mark-up) based on both (a) the efficient roaming rate and (b) on the roll out speed of a new efficient generic entrant. The asymmetric mark-up based on point 10 of the Recommendation is a weighted average of the generic efficient incremental cost and the efficient incremental roaming cost. E.g. if the efficient roll out means the new entrant has a coverage of 40% in year X, the efficient roaming cost will weigh for 60% in the calculation of the weighted average (because 60% of all traffic needs to be terminated on third-party network for which roaming needs to be paid).

13. ARCEP abstracts from individual roaming agreements to prevent bad incentive effects that the asymmetric regulation could have on the commercially negotiated roaming rates. For example ARCEP notes that: "The use of 'efficient costs for generic access to the network of a third-party operator', both by its generic nature — and therefore separate from the economic conditions of individual access of each of the operators concerned — and by its effective nature, therefore has the advantage of not having any retroactive effect on the economic conditions — and in particular the tariff levels — of these individual contracts." (notified decision p. 61) and also: "The efficient costs [efficient incremental roaming rates] resulting from this assessment are not communicated to the market operators in order to avoid influencing commercial negotiations between operators, and in particular to avoid constituting a lower limit that hinders the negotiations between host and housed operators." (notified decision p. 63)

2.1.1 Circularity argument

14. An important argument of the Commission is that asymmetry based on the roaming rates raises serious doubts because it will introduce circularity. The Commission notes that new MVNOs and new MNOs may gain additional negotiating power if all operators knew in advance that the regulator would not grant asymmetric rates. When modelling the efficient new entrant it is, in view of the Commission, therefore wrong and circular to conclude that incoming calls under national roaming will lead to higher MTRs, because it is this regulatory approach that will induce higher commercial roaming rates (effect 1, see figure 1) and consequently higher MTRs (effect 2, see figure 1). The two effects involved here are schematically drawn in figure 1.

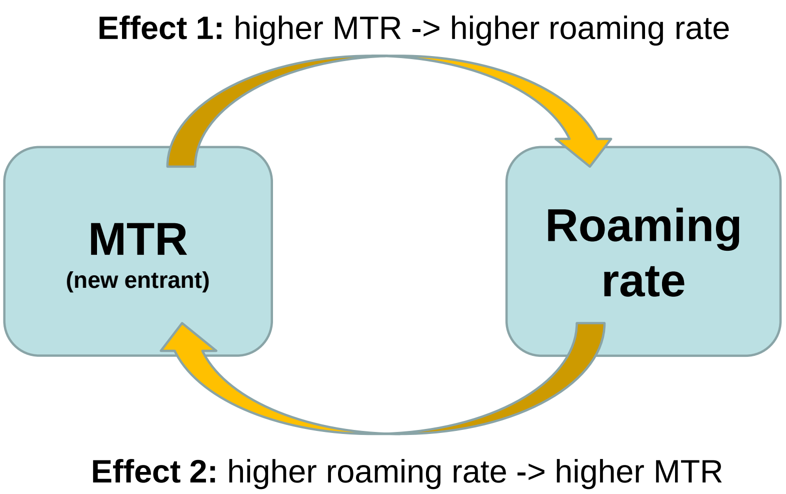

Figure 1.'Circularity effects' between roaming rates and MTRs.

15. Before assessing the circularity issue, BEREC notes that the Recommendation does not give guidance on the circularity issue and on the fact how to deal with costs of MVNOs and new entrant MNOs that consist of commercially negotiated roaming services. Circularity has no clear relation with the conditions mentioned in point 10 of the Recommendation.[2] The assessment of the circularity issue is therefore not a matter whether the conditions of point 10 are met, but an assessment of economic effects that are not discussed in the Recommendation. BEREC will first assess the first and then the second circularity effect.

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[2] These conditions are that (a) a new mobile entrant operating below the minimum efficient scale incurs higher per-unit incremental costs than the modelled operator and (b) there are impediments on the retail market to market entry and expansion.

Effect 1

16. Although the Commission does not give a detailed explanation of the effects and why they would happen, BEREC considers that effect 1 is likely if the asymmetry is anticipated by the hosting MNO that negotiates the roaming rates with the new entrant. After all, higher MTRs for new entrants will mean that (a) hosting MNO will have a higher cost through the higher MTRs that it pays and (b) new entrants will receive a higher revenue through the higher MTRs (which is the equivalent of a lower cost). It is likely that hosting MNOs will at least partly pass on their own higher costs and the competitors lower cost in a higher commercial roaming rate.[3] Because all potential hosting MNOs face a similar cost change, it is not likely that this cost change will be competed away. Effect 1 means that the benefit that new entrants get from their higher MTR, will likely be – at least partly – removed through a higher roaming rate.

17. A remaining question is whether in this case the asymmetry could be anticipated by the hosting MNOs. It is difficult to judge whether this is the fact here in this particular case. However, BEREC considers that this issue should be assessed for the situation that the regulation may be anticipated. After all, regulation that is imposed now should also be appropriate in the same case in the future where it certainly may be anticipated.[4] It would therefore not be correct to judge this case as a one shot event in which the regulation could not be anticipated and therefore effect 1 is not there for this case now (but would be there in the future).

18. Based on the preceding assessment, BEREC concludes that effect 1 is likely to occur to some extent in the future if the hosting MNOs anticipate the asymmetry.

Effect 2

19. Regarding the second effect it is important to note that ARCEP abstracted from individual roaming agreements in determining the efficient roaming rate. Therefore, the results of individual roaming agreements will not be directly passed-through in a different MTR. Certainly it is not so that a higher roaming rate negotiated now or in the future will be passed through in higher MTRs within this regulatory period. In other words: there cannot be a retroactive effect because of higher roaming rates. The Commission does not address these careful measures of ARCEP in its serious doubts letter. However, despite the measures that ARCEP took to prevent effect 2, it seems not possible to fully abstract from actual roaming rates in setting the regulated rate. Somehow at least the most attractive roaming agreements have to be taken into account in determining the efficient roaming rate and the amount of asymmetry based on that. Based on this BEREC concludes that effect 2 is likely to occur, although not in a direct way and not retroactively within this regulatory period.

[3] This is a standard mechanism of cost pass-through that will be present in a monopoly or full competition situation (the effect will be increasingly *stronger* with increasing competition). The “compensation mechanism” that causes a higher cost input to be compensated by a higher commercial rate, is likely to occur in any situation where the competing operators providing the commercial service face the same situation.

[4] Otherwise there would be a discriminatory effect between current regulation (possibly justified because it could not be anticipated) and future regulation (possibly not justified because it could be anticipated).

Conclusion on circularity

20. Taking effect 1 and 2 together, BEREC concludes that these effects are likely to occur to some extent if the hosting MNOs anticipate the asymmetry. The occurrence of the effects would create circularity. Although it is not a direct circularity that will create effects within this regulatory period for these operators and will therefore not create an uncontrolled feedback loop within regulatory period (which can be seen as the strict meaning of circularity), these effects are certainly relevant for future regulation. BEREC considers that effect 1 is also relevant in itself, independent on the existence of effect 2 and a closed loop resulting in direct circularity. Effect 1 means that, when asymmetry is anticipated, the benefit that new entrants get from their higher MTR, will likely be – at least partly – removed through a higher roaming rate.

2.1.2 Roaming rates not scale sensitive

21. ARCEP remarks its notified decision that: "Beyond this temporary period [period of asymmetry], the full-MVNO will have been able to achieve a sufficient size and economies of scale in order to obtain more favourable access conditions, enabling it to remain active on the market under the operational conditions of the efficient generic operator." (notified decision, p. 60). ARCEP refers to the minimum efficient scale as a market share of 20% as mentioned in the Recommendation.

22. In view of the Commission point 10 of the Recommendation should not be applied to MVNOs, because their MTRs would at all times be determined by negotiated national roaming rates, which may not be as scale sensitive as ARCEP suggests.

23. BEREC agrees with the Commission that it is doubtful whether roaming rates are scale sensitive. After all, it remains unclear whether a larger MVNO will be able to obtain more favourable access conditions, at least ARCEP does not provide sufficient evidence on this. BEREC notes that a below 20% market share alone is not sufficient evidence to conclude the operator is below minimum efficient scale and also other circumstances need to be considered. It is therefore doubtful whether an MVNO with a market share of below 20% is operating below the minimum efficient scale of an MVNO.[5] The 20% market share mentioned in the Recommendation clearly seems to be relevant for an MNO and not for an MVNO. Therefore, it is questionable whether the point 10 of the Recommendation, namely that the new entrant is operating below minimum efficient scale, is even applicable to MVNOs. BEREC therefore concludes that ARCEP did not sufficiently justify that the MVNOs operate below their minimum efficient scale.

[5] MVNO entry and operation is neither subject to license conditions nor to coverage obligations. Moreover, MVNOs prevent the significant upfront investments in network roll-out (that have large fixed costs and create economies of scale) by acquiring wholesale inputs (roaming) form established network operators. Hence, with the existence of wholesale inputs and the capability to concentrate on market niches, scalability issues in mobile networks can be washed away to the extent these wholesale inputs are provided. A confirmation of this can be seen in the fact that a large number of MVNOs in the EU sustainably operate below a market share of 1%.

2.1.3 General conclusion on national roaming cost

24. Based on the preceding assessment, BEREC concludes that the Commission's serious doubts regarding the asymmetry based national roaming cost are justified.

2.2 Asymmetry based on traffic imbalance

25. The second part of the asymmetry of the price caps in the notified decision is based on grounds that are discussed in the ERG common position on symmetry of 28 February 2008 (hereafter: common position).[6] Section 3.5 of this common position gives a possible justification for asymmetry when MTR's are still above cost and there is a traffic imbalance. The traffic imbalance concerned is the difference between the amount of voice terminating traffic that is send and received by an individual operator. If operators have more outgoing than incoming traffic they could be harmed by MTR's that are still above cost. It is clear that operators with more outgoing traffic pay an extra amount of revenue to other operators compared with the situation where MTR's are at cost. The common position concludes that based on national specificities a transitory asymmetry can be applied. The common position mentions in its concluding part (p. 101) this can only be done if there are high traffic imbalances as result of operator strategies.

26. ARCEP's reasoning is that new entrants need to engage in a commercial strategy of "abundance plans" to gain market share. These abundance plans are offers that are priced in such a way that they generate a lot of calls. This usually results in a situation where the users of these plans initiate more outgoing calls than they receive incoming calls. Therefore, operators that focus on abundance plans are expected to have more outgoing than incoming traffic. ARCEP concludes this necessary strategy will create financial imbalances for a new efficient generic entrant. Referring to the common position, ARCEP considers it justified and proportionate that new entrants are partially compensated for this financial imbalance. This partial compensation is implemented through the application of a surcharge in the price cap of the three new entrants. This surcharge is strictly limited to the year 2012, since in 2013 MTR's will be at cost. ARCEP also notes this mark-up is compatible with the Recommendation of the Commission on call termination rates, since the application of this surcharge is restricted to a period before the deadline of 31 December 2012 in the Recommendation, where all termination rates should comply with the Recommendation.

27. The Commission notes in the serious doubts letter that traffic is not imbalanced because of the presence of small and large operators in a market per se but is often the result of a distinct commercial strategy of the new entrant (e.g. uniform vs. on-net/off-net price differentiation). This should not normally justify higher termination rates of new entrants.

28. However, BEREC notes that in its notified decision ARCEP does not claim the imbalance results from the presence of small and large operators. Also ARCEP does not dispute that the imbalance is

[6] ERG (07) 83: http://erg.eu.int/doc/publications/erg_07_83_mtr_ftr_cp_12_03_08.pdf.

due to a distinct commercial strategy. On the contrary, the argument of ARCEP is precisely that new entrants *need* to engage in a commercial strategy of “abundance plans” to gain market share. The commercial strategy that the Commission mentions as a factor that often causes traffic imbalances, is therefore exactly the factor that is mentioned by ARCEP. BEREC therefore concludes that this part of the reasoning of the Commission does not address ARCEP’s reasoning properly and therefore does not explain where the reasoning of ARCEP is incorrect.

29. The Commission also notes that ARCEP shows no direct relationship between (i) the financial imbalance stemming from traffic exchange and (ii) the termination costs incurred by the operator subject to such imbalance. The Commission claims this relationship is relevant in the light of the retail prices in France, which are still well above MTR, and which raises the question whether operators should be compensated in those instances where they are not incurring losses on off-net calls.

30. BEREC considers that the reasoning of the Commission on this issue is not sufficiently clear. Firstly, BEREC’s sees a clear relationship between the financial imbalance and the termination cost incurred. More specifically there is a clear relationship between on the one side the amount that MTR’s are above cost and the traffic unbalance, and on the other side the added financial imbalance – i.e. the added costs for new entrants – that results from that. According to BEREC this relationship is sufficiently clear. To give an example, say termination cost is 1 per minute, but the termination price cap is still at 2 per minute. Say the new entrant sends 100 but receives only 50 minutes. Then there is a net effect of 50 [(2-1)*(100-50)] on the financial balance between the new entrant and other operators due to the fact that termination rates are above cost.

31. Secondly, BEREC does not consider that it is relevant in this context that retail prices are still well above MTR level. Even if the retail prices are well above the part of the network cost of new entrants (which is not the full cost of an operator), this does not change the fact that new entrants have extra costs because of MTR’s that are above cost and there is a traffic imbalance. These extra costs affect the competitive relation between existing operators and new entrants. The fact that new entrants may still earn a marginal profit[7] on these off-net calls does not change this competitive effect.

32. Based on the preceding assessment of the Commission reasoning, BEREC concludes that the Commission’s serious doubts regarding the surcharge are not justified.

2.3 Compliance with the non-discrimination principle as set out in the Article 8(5) (b) of the Framework Directive

33. The Commission takes the view that the price control remedy proposed by ARCEP would lead to price discrimination between the (established) host operators and the new entrant operators. The Commission considers that both the host and the entrant operators provide the same termination service over the same mobile network and ARCEP did not provide an adequate justification as regards

[7] Which is difficult to check since MTR’s only a part of the total costs for a call.

the objective cost differences that would warrant asymmetric MTRs, even when the new MNO terminates the calls in its own network.

34. ARCEP has proposed asymmetric termination rates for the new entrants based on arguments relating to (a) national roaming costs (referring to point 10 of the Recommendation) and (b) traffic imbalance costs (referring to the ERG common position). BEREC notes that MTRs should be, without adequate justification, symmetric. However, asymmetric MTRs may be necessary and appropriate in some specific cases.

35. Based on the preceding assessment, BEREC does not find ARCEP's reasoning regarding the national roaming costs adequately justified. Accordingly, BEREC concludes that the Commission's serious doubts regarding the compliance with the non-discrimination principle are justified. BEREC shares the Commissions view that the roaming cost part of the asymmetry does not comply with community law, which is a sufficient condition to justify serious doubts that is mentioned in article 7a(1) of the Framework Directive.

2.4 Creation of barriers to the internal market

36. The Commission is concerned that the (higher) asymmetric termination rates for the three new entrant operators set by ARCEP may create barriers to the internal market as the three new entrant operators will be able to benefit from this (higher) rate at the expense of the operators, and ultimately the consumers, in the Member State from which the call originates and where termination rates are set using the pure BULRIC methodology. The Commission continues that, although host MNOs in France may in turn benefit from this via higher national roaming rates, operators and their subscribers in other Member States will still suffer from higher rates in France. The Commission also points out, that in several Member States a symmetric price control remedy was imposed on the full MVNOs following their entry in the market.

37. BEREC has already addressed a similar line of argument advanced by the Commission in its previous opinion in the article 7a phase II Dutch cases NL/2012/1284-1285 (BoR(12)23). BEREC agrees with the Commission that – like in the Dutch case – also in this French case the new entrants' higher rates will also be paid by operators and ultimately their subscribers in other Member States from which the call originates. However, BEREC also notes the Commission does not quantify this effect and this effect seems relatively minor given the size of the asymmetry, the market share the new entrants and percentage of traffic that is international. Therefore, it seems doubtful whether the notified measure would create a barrier to the internal market. At least this seems less important than the noncompliance with the non-discrimination principle.

38. However, in case the measure does not comply with community law, the creation of barriers to the internal market is not a necessary condition to justify serious doubts. Therefore, this issue does not change the overall conclusion.

3 Conclusion

39. Based on the preceding assessment, BEREC concludes that the Commission's serious doubts on the asymmetry that is based on national roaming costs are justified while the serious doubts on the asymmetry that is based on traffic imbalance costs are not justified.

40. Based on the preceding conclusion BEREC proposes that ARCEP amends its notified decision by removing the asymmetry based on national roaming cost.

41. ARCEP's concludes that the efficient incremental *network* cost of a new entrant is not higher than that of an efficient existing operator. This conclusion does not seem to be restricted to the French market. Given that and given the conclusion it is not appropriate to take higher roaming cost into account, it is not clear when point 10 of the Recommendation can be applied in practice. Therefore, BEREC also proposes that the Commission gives further guidance on the applicability of point 10 of the Recommendation.