

**FINAL DECISION ON**

**Cost-of-capital rate of MEO – Serviços de**

**Comunicações e Multimédia, S.A.**

**(2020 financial period)**

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## 1. Framework

The cost-of-capital rate expresses the appropriate rate of return to compensate for the opportunity cost of the investment.

In the context of the regulation of the electronic communications market, the cost-of-capital rate is determined in order to: (i) ensure the right investment incentives; (ii) ensure that there are no market distortions, through discriminatory and anti-competitive practices; (iii) eliminate possible barriers to the entry of new competitors; and, (iv) protect consumers from excessive prices, the definition of a methodology that allows the cost-of-capital rate to be determined without any accounting and/or analytical constraints, in a proper manner to remunerate the investments of regulated companies, being deemed to be essential.

Autoridade Nacional de Comunicações (hereinafter referred to as “ANACOM”) has established, since 2010, the methodology<sup>1</sup> for calculating the cost-of-capital rate of MEO - Serviços de Comunicações e Multimédia, S.A., (hereinafter “MEO”), and determining the cost-of-capital rate to be considered by this operator for regulatory purposes.

By decision<sup>2</sup> dated 17 April 2020, ANACOM decided to suspend the tasks aimed at defining the cost-of-capital rate for regulatory purposes to be considered in MEO’s 2020 cost accounting system, until greater prominence was given to results of the work by the European Commission (hereinafter “EC”) and the Body of European Regulators for Electronic Communications (hereinafter “BEREC”), taking into account EC Communication 2019/C 375/01 of 6 November 2019<sup>3</sup> with the title “Commission Notice on the calculation of the cost-of-capital for legacy infrastructure in the context of the Commission’s review of national notifications in the EU electronic communications” (hereinafter the “Commission Notice”). Notwithstanding, ANACOM remained entitled, as stated in the Decision, to carry out a reassessment of this situation as from 30 June 2020.

The aforementioned Commission Notice thus aims to encourage the harmonization of the calculation of the cost-of-capital rate for regulatory purposes in the EU space and for the electronic communications sector. The values of parameters considered in the calculation

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<sup>1</sup> Available on the website: <https://www.anacom.pt/render.jsp?contentId=1010799>

<sup>2</sup> Available on the website: <https://www.anacom.pt/render.jsp?contentId=1523188>

<sup>3</sup> Available on the website: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52019XC1106%2801%29>

of the Weighted Average Cost-of-Capital (hereinafter referred to as “WACC”) will be calculated and published every year by BEREC, based on the methodology set out in that communication. EC will use these values as a reference for the review of draft measures notified under Article 7 of the Framework Directive (now article 32 of the Directive (EU) 2018/1972, of the European Parliament and of the Council, of 11 December 2018).

It is stressed that paragraph 71 of point 9 of the Commission Notice<sup>4</sup> clearly states that when reviewing notifications under the procedure laid down in Article 7 (now article 32 of the referred Directive (EU) 2018/1972), EC will use the methodology described in the Notice from 1 July 2020, as a rule. However, in justified cases and at the request of the notifying National Regulatory Authority (hereinafter referred to as “NRA”), the Commission will not base its review of draft measures on this methodology during a transitional period of up to one year (starting from 1 July 2020).

With respect to the work carried out by BEREC, this organization published on 29 June 2020 the *BEREC Report on WACC parameter calculations according to the European Commission’s WACC Notice of 7<sup>th</sup> November 2019 (WACC parameters Report 2020)*<sup>5</sup>. This document presents the calculations results for each WACC parameter, following as closely as possible the methodology outlined in the Commission Notice. BEREC assumes that NRAs take into account the values of these parameters in determining the WACC.

It is emphasized that, although the Commission Notice does not match in all its points the methodology that ANACOM has been applying in recent years, as this Authority has already mentioned in its decision of 17 April 2020, ANACOM supports the harmonization efforts between Member States in matters related to the calculation of the cost-of-capital rate for regulatory purposes. In fact, ANACOM understands and welcomes EC’s harmonization efforts, which also contribute to regulatory predictability and, most importantly, to reducing potential competition asymmetries in the electronic communications sector between operators in the various Member States. In this regard, ANACOM considers that it should follow the guidelines of the referred Commission Notice, sharing EC’s view that “it will discourage the distortion of investments by inconsistencies in NRAs’ approaches over time and across the Union, which could harm the functioning of the Digital Single Market.”

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<sup>4</sup> Commission Notice, point 9: “Transitional period towards the adoption of the methodology in this Notice”.

<sup>5</sup> Report published on 06/29/2020 on the website [https://berec.europa.eu/eng/document\\_register/subject\\_matter/berec/reports/9364-berec-report-on-wacc-parameter-calculations-according-to-the-european-commission8217s-wacc-notice](https://berec.europa.eu/eng/document_register/subject_matter/berec/reports/9364-berec-report-on-wacc-parameter-calculations-according-to-the-european-commission8217s-wacc-notice).

Moreover, in cases where the work of international bodies is silent on the approach to be followed, ANACOM believes that the best approach, in terms of promoting regulatory certainty, is to maintain the methodology used to date.

It should also be noted that since the new methodology is dependent, as described above, on calculation results published on an annual basis by BEREC, the timing of the determination of MEO's cost-of-capital rate will henceforth have to be adjusted to the moment when BEREC publishes the result of its work.

In this context, after reviewing and reflecting on the Commission Notice and the results of BEREC's work referred to above, ANACOM determined<sup>6</sup>, on 22 October 2020, to submit the draft decision on the cost-of-capital rate of MEO – Serviços de Comunicações e Multimédia, S.A. (2020 financial year) to a prior hearing of interested parties and general consultation procedures, under articles 121 and 122 of the Administrative Procedure Code (APC), in both cases setting a deadline of 20 working days for interested parties to comment.

Two contributions were received within the deadline set, ANACOM's analysis and understanding thereof having been set out in the "Report on the public consultation and prior hearing of interested parties", approved by this Authority by determination of 14 January 2021.

Under the same determination, the draft final decision on MEO's cost-of-capital rate applicable to the 2020 financial year was also approved, as well as its notification to EC, BEREC and NRAs of other Member States, pursuant to article 57, paragraph 1, of ECL and in the context of article 7, paragraph 3, of Directive 2002/21/EC of the European Parliament and of the Council of 7 March, as amended by Directive 2009/140/EC of 25 November (now article 32 of Directive (EU) 2018/1972 of the European Parliament and of the Council of 11 December 2018), together with the respective grounds, this notification having been submitted on 20 January 2021.

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<sup>6</sup> MEO's cost-of-capital rate applicable to the 2020 financial year - public consultation, available at <https://anacom.pt/render.jsp?contentId=1566584>

EC submitted a request for information to ANACOM on 27 January 2021, with two issues relating in general to: a) products affected by the update of the WACC; b) schedule for updating these products' prices.

In its response to EC's issues, ANACOM clarified, on 1 February 2021, that the WACC value now determined will be used in MEO's cost accounting system, thus feeding all products and services, namely the copper wholesale offers, the leased lines offer, the duct access offer and the poles access offer, which are subject to price regulation. The Authority also reported on the latest dates on which the prices of regulated services were reviewed, clarifying that these prices are not automatically updated when a new value for the WACC is determined. ANACOM also informed EC that it plans to update prices in 2021 for lines connecting the Mainland and the Autonomous Regions of the Azores and Madeira (MAM lines), for inter-island leased lines and access to ducts and poles, as well as to undertake a review of former markets 3a, 3b and 4.

Subsequently, on 18 February 2021 the EC expressed its views on the notified draft final decision, making the following three comments with respect to it:

1. EC welcomes ANACOM's incorporation of the harmonised approach in relation to the calculation methodology for the cost-of-capital rate of legacy telecommunication infrastructures for regulatory purposes. According to EC, ANACOM fully aligns its methodology with the Commission Notice and uses, where relevant, the parameters set by BEREC in 2020.
2. Nevertheless, EC notes that the prices of several regulated access products in Portugal have not been updated for quite some years. In particular, the prices of regulated access to ducts and poles date from 2006 and 2010 respectively, to copper local loop from 2010, and to leased lines from 2012.
3. The Commission recalls that timely market reviews are of utmost importance to ensure appropriate regulatory measures and market predictability. The Commission strongly encourages ANACOM to regularly review the markets and update the prices of such key access products and services without further delays.

The above-mentioned communications with EC, referred to above, as well as EC's comments on the draft decision, are available on ANACOM's website together with this decision.



In light of comments made by EC, ANACOM intends to turn the draft decision on the cost-of-capital rate to be applied to MEO in 2020 into a final decision, as set out in the following chapters, without any changes to the draft decision, apart from references to the consultation procedure with EC, BEREC and NRAs of other Member States, and informs that this Authority will take due account of EC's comments in the definition and implementation of its regulatory action.

## **2. Cost-of-capital rate**

### **2.1. Methodology**

With regard to the determination of each of the parameters for calculating the WACC, EC has invited BEREC to estimate WACC parameters in accordance with the approach described in the Commission Notice. According to EC, this will facilitate NRAs' work in preparing WACC periodic reviews and EC's analysis of subsequent notifications. The methodology and values of the various parameters can be found in the above-mentioned BEREC report.

It should also be emphasized that in the annual calculation exercise, BEREC, in close cooperation with EC, will estimate:

- a) parameters reflecting general economic conditions;
- b) company-specific parameters for the peer group. As regards parameters reflecting general economic conditions, BEREC will estimate the Risk-Free Rate (RFR) for each EU member state and a single Equity Risk Premium (ERP).

In terms of company-specific parameters, BEREC has prepared a list of companies suitable for the peer group, and estimated the equity beta, gearing, debt premium and cost of debt for each company included in the list. In addition, BEREC describes factors justifying the removal of one or more companies from the list provided by NRAs to take into account national specificities.

For a detailed and in-depth understanding of the methodology for calculating each of the parameters, we recommend a joint analysis of the two above-mentioned documents, the Commission Notice and the BEREC report, on which this document is based.

## 2.2. Parameter Values

### 2.2.1. Calculating the risk-free interest rate (RFR)

To determine the RFR per country, BEREC relied on data published by Eurostat (*Eurostat Long term government bond yields 2015M04 to 2020M03*), according to a five-year (1 April 2015 to 31 March 2020) arithmetic average of yields on 10-year domestic government bonds for each EU member state. For Portugal, the calculated reference value is 2.16%. Results for each Member States are presented in Table 1.

**Table 1: BEREC Risk Free Rate EU Member States**

Country Code	Country	Country Credit Rating	5-year arithmetic average
AT	Austria	AA+	0.46
BE	Belgium	AA	0.57
BG	Bulgaria	BBB	1.41
HR	Croatia	BBB-	2.53
CY	Cyprus	BBB-	2.58
CZ	Czech Rep.	AA-	1.16
DK	Denmark	AAA	0.32
EE	Estonia	AA-	1.09
FI	Finland	AA+	0.44
FR	France	AA	0.57
DE	Germany	AAA	0.17
EL	Greece	BB-	5.67
HU	Hungary	BBB	2.96
IE	Ireland	AA-	0.75
IT	Italy	BBB	1.96
LV	Latvia	A+	0.67
LT	Lithuania	A+	0.59
LU	Luxembourg	AAA	0.29
MT	Malta	A-	1.09
NL	Netherlands	AAA	0.37
PL	Poland	A-	2.93
PT	Portugal	BBB	2.16
RO	Romania	BBB-	4.06
SK	Slovakia	A+	0.66
SI	Slovenia	AA-	0.94
ES	Spain	A	1.30
SE	Sweden	AAA	0.49
UK	United Kingdom	AA	1.25

**Source:** BEREC Report on WACC parameter calculations according to the European Commission's WACC Notice of 7<sup>th</sup> November 2019 (WACC parameters Report 2020)

## 2.2.2. Peer group

BEREC states that it has closely followed the criteria in the Commission Notice when deciding on which companies to include in the peer group, taking into consideration the following criteria to prepare this group. As such, companies are required to:

- a) be listed on a stock exchange and have liquidly traded shares;
- b) own and invest in electronic communications infrastructure;
- c) have their main operations located in the EU;
- d) have an investment grade (credit rating BBB/Baa3 or above); and,
- e) not be, or have not been recently, involved in any substantial mergers and acquisitions.

According to BEREC, where a company meets four of the five criteria it is considered appropriate for inclusion in the peer group. However, it is stressed that a company must meet criterion 1 as a prerequisite for inclusion.

Based on both the referred criteria and national specificities, the peer group proposed by BEREC for 2020 is shown in Table 2.

**Table 2: BEREC peer group 2020**

Company	Country	S&P rating as of 22 April 2020	Rating last reviewed by S&P	Stock Symbol
<b>BT Group plc</b>	UK	BBB	20 Sept. 2019	BT/A LN
<b>Deutsche Telekom-AG</b>	DE	BBB+	01 April 2020	DTE GR
<b>Elisa Oyj</b>	FI	BBB+	26 March 2020	ELISA FH
<b>Koninklijke KPN N.V.</b>	NL	BBB	13 March 2020	KPN NA
<b>NOS</b>	PT	BBB-	27 March 2020	NOS PT
<b>Orange S.A.</b>	FR	BBB+	27 Sept. 2019	ORA FP
<b>Proximus S.A.</b>	BE	A	10 April 2020	PROX BB
<b>Tele 2</b>	SE	BBB	25 Nov. 2019	TEL2B SS
<b>Telecom Italia</b>	IT	BB+	28 Oct. 2019	TIT_MI
<b>Telefónica</b>	ES	BBB	01 April 2020	TEF SM
<b>Telekom Austria</b>	AT	BBB+	10 April 2020	TKA AV
<b>Telenet</b>	BE	BB-	29 July 2019	TNET BB
<b>Telia Company AB</b>	SE	BBB+	20 January 2020	TELIA SS
<b>Vodafone Group plc</b>	UK	BBB	01 August 2019	VOD LN

Source: BEREC Report on WACC parameter calculations according to the European Commission's WACC Notice of 7<sup>th</sup> November 2019 (WACC parameters Report 2020)

As regards each Member State, BEREC considers that NRAs should, where necessary, select from the above table the set of companies that most reflects national specificities.

According to paragraph 67<sup>7</sup> of the Commission Notice, this may involve removing companies from the listed group, but not adding any other companies. BEREC recommends that NRAs maintain where possible a peer group that is as wide as possible, using companies in Table 23 that are more representative of national specificities.

According to BEREC, in order to avoid “arbitrary” choices, the removal of companies from the list could be justified for the following reasons:

- a) Certain companies in the peer group may not reflect the size of the operator holding significant market power (SMP) in the particular Member State;
- b) Competition conditions within the electronic communications sector, and in particular infrastructure-based competition, may vary between Member States;
- c) The share of regulated vs non-regulated revenues of peer group members may vary;
- d) The scope of segments of activity of certain companies in the peer group may differ significantly from the types of business of the SMP operator to an extent of not being representative.

It is stressed that BEREC does not consider it appropriate to exclude companies from the peer group on the basis of the credit rating or risk-free rate of the Member State, as these may not be directly comparable to conditions experienced by the SMP operator in the Member State.

In light of the above, this Authority considers that, given that most<sup>8</sup> companies considered by BEREC for the purpose of comparability had already been considered appropriate by ANACOM in the methodology in force to date, and also bearing in mind that no company is perfectly comparable to MEO, there are advantages in having a relatively large set of comparable companies in order to mitigate the influence of hypothetical characteristics that are distinctive of MEO. Thus, ANACOM believes that taking the full set of companies proposed by BEREC into account is the most advisable option.

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<sup>7</sup> §67 sets out as follows: “Regarding the company-specific parameters, BEREC will prepare a list of companies suitable for the peer group and estimate the equity beta, gearing, debt premium and cost of debt for each company included in the list. Further, BEREC will describe factors that may justify NRAs removing one or more companies from the list to take account of national specificities”.

<sup>8</sup> BT Group, Deutsche Telekom, Elisa OYJ, KPN NV, Nos SGPS, Orange, Proximus, Telecom Italia, Telefónica, Telekom Austria and Telia Company.

### 2.2.3. Debt premium and cost of debt

BEREC estimated the debt premiums for the companies in the peer group listed above from which NRAs can select the appropriate value for their regulated operator. This value will be later added to the estimated domestic risk-free interest rate to derive the cost of debt for each company.

**Table 3: Debt premium and Cost of debt**

Company	Debt premium (basis point)	Domestic RFR	Cost of debt
BT GROUP PLC	167	1.25%	2.92%
DEUTSCHE TELEKOM AG	131	0.17%	1.48%
ELISA OYJ	100	0.44%	1.44%
KONINKLIJKE KPN NV	117	0.37%	1.54%
NOS	42	2.16%	2.58%
ORANGE	87	0.57%	1.44%
PROXIMUS	89	0.57%	1.46%
TELE2 AB-B SHS	178	0.49%	2.27%
TELECOM ITALIA SPA	161	1.96%	3.57%
TELEFONICA SA	45	1.30%	1.75%
TELEKOM AUSTRIA AG	81	0.46%	1.27%
TELENET GROUP HOLDING NV	302	0.57%	3.59%
TELIA CO AB	150	0.49%	1.99%
VODAFONE GROUP PLC	170	1.25%	2.95%

**Source:** BEREC Report on WACC parameter calculations according to the European Commission's WACC Notice of 7<sup>th</sup> November 2019 (WACC parameters Report 2020)

In view of the methodology described above, this Authority believes that the value of the debt premium to be considered for the purpose of calculating MEO's cost-of-capital rate is 1.3% (arithmetic average of all companies considered based on the Debt premium column - basis point) of Table 3.

### 2.2.4. Calculating the beta and gearing

Given the selected peer groups (*vide* point 2.2.2), BEREC's approach to estimate the equity beta was as follows:

- a) Estimate the equity beta for each company;
- b) Estimate the gearing level for each company;

- c) Derive the asset betas from each company in the peer group, including the SMP operator (using the equity beta and gearing level for each company);
- d) Relever the asset beta to obtain the final equity beta.

BEREC provided the data for asset beta and gearing for each company of the peer group, from which the corresponding ranges of values for each parameter could be used for estimating the final equity beta in the WACC formula by each NRA. Values determined by BEREC for the equity beta, gearing and asset beta are shown in Table 4 below.

**Table 4: BEREC peer group 2020 – Equity beta, Gearing, Asset beta**

Company	Equity Beta	Gearing	Asset beta
<b>BT GROUP PLC</b>	0.65	33.14%	0.47
<b>DEUTSCHE TELEKOM AG</b>	0.91	42.57%	0.57
<b>ELISA OYJ</b>	0.59	13.51%	0.52
<b>KONINKLIJKE KPN NV</b>	0.72	38.75%	0.48
<b>NOS</b>	0.77	25.80%	0.60
<b>ORANGE</b>	0.85	43.99%	0.52
<b>PROXIMUS</b>	0.74	19.48%	0.62
<b>TELE2 AB-B SHS</b>	0.80	16.64%	0.69
<b>TELECOM ITALIA SPA</b>	1.12	63.80%	0.47
<b>TELEFONICA SA</b>	1.07	50.39%	0.58
<b>TELEKOM AUSTRIA AG</b>	0.69	41.82%	0.45
<b>TELENET GROUP HOLDING NV</b>	0.63	47.55%	0.38
<b>TELIA CO AB</b>	0.75	34.10%	0.53
<b>VODAFONE GROUP PLC</b>	0.80	45.77%	0.49

**Source:** BEREC Report on WACC parameter calculations according to the European Commission's WACC Notice of 7<sup>th</sup> November 2019 (WACC parameters Report 2020)

On the basis of the methodology described above, this Authority believes that the value<sup>9</sup> of beta<sup>10</sup> and gearing to be considered for the purpose of calculating MEO's cost-of-capital rate should be calculated for the entire peer group, resulting in a value of 0.7921% and 36.9507% respectively.

### **2.2.5. Calculating the equity risk premium (ERP)**

The Commission Notice states that an EU-wide equity risk premium is considered to be the most appropriate approach for determining the cost-of-capital rate for regulatory purposes

<sup>9</sup> Obtained through the arithmetic average of values of Table 4.

<sup>10</sup> Arithmetic average of the Equity Beta column.

as this is consistent with the evidence suggesting that European financial markets are increasingly converging, coupled with the fact that a significant portion of electronic communications companies' capital is held by non-domestic investors.

To determine the value of this parameter, BEREC carried out an analysis of constraints, limitations and compatibility of the information that could be processed, as described in the report produced by that body.

As a result of the work carried out, BEREC set the ERP value at a range between 4.18% and 5.31% (*vide* Table 5), depending on whether the calculation based on the historical elements of the equity return and the bond return was carried out by reference to a geometric mean (lower limit) or to an arithmetic mean (upper limit).

**Table 5: Equity Risk Premium**

Country	Geometric mean (%)	Arithmetic mean (%)	Available years weight (%)
<b>Austria</b>	2.7	21	100% (120/120)
<b>Belgium</b>	2.1	4.1	100% (120/120)
<b>Bulgaria</b>	7.1	7.7	11.67% (14/120)
<b>Croatia</b>	7.9	8.1	10% (12/120)
<b>Cyprus</b>	25.3	26.5	4.17% (5/120)
<b>Czech Rep,</b>	4.6	5	9.17% (11/120)
<b>Denmark</b>	3.4	5.1	100% (120/120)
<b>Estonia</b>			
<b>Finland</b>	3.4	5.1	100% (120/120)
<b>France</b>	3.1	5.3	100% (120/120)
<b>Germany</b>	4.9	8.2	98.3% (118/120)
<b>Greece</b>	7.2	8.5	15% (18/120)
<b>Hungary</b>	0.7	0.9	9.17% (11/120)
<b>Ireland</b>	2.6	4.6	100% (120/120)
<b>Italy</b>	3.1	6.4	100% (120/120)
<b>Latvia</b>	9.7	10.1	12.50% (15/120)
<b>Lithuania</b>	3.8	4.2	12.50% (15/120)
<b>Luxembourg</b>			
<b>Malta</b>			
<b>Netherlands</b>	3.3	5.5	100% (120/120)
<b>Poland</b>	3.1	3.2	15.83% (19/120)
<b>Portugal</b>	5	9.1	100% (120/120)
<b>Romania</b>	7.1	7.2	5.% (6/120)
<b>Slovakia</b>	1.6	1.7	12.50% (15/120)
<b>Slovenia</b>	3.5	3.6	12.50% (15/120)
<b>Spain</b>	1.6	3.5	100% (120/120)

<b>Sweden</b>	3.2	5.4	100% (120/120)
<b>United Kingdom<sup>11</sup></b>	3.6	4.9	100% (120/120)
<b>EU-ERP</b>	<b>4.18</b>	<b>5.31</b>	

**Source:** BEREC Report on WACC parameter calculations according to the European Commission's WACC Notice of 7th November 2019 (WACC parameters Report 2020)

Notwithstanding BEREC's determination of a range of values within which it expects the ERP parameter to lie, it recognizes that the EC Notice note favours the use of the value determined on an arithmetic average basis<sup>12</sup>, NRAs being required to justify any deviations.

It should be noted that ANACOM agrees with the calculation of this parameter using the arithmetic average, which has in fact been used in previous actions of this Authority regarding the cost-of-capital, reason for which this Authority considered it appropriate to use the value of 5.31% as reference for the ERP parameter in the scope of the calculation of MEO's cost-of-capital rate for 2020.

#### **2.2.6. Tax rate**

According to paragraph 60<sup>13</sup> of the Commission Notice, the use of the relevant domestic corporate tax rate to estimate the pre-tax WACC, which is the common approach adopted by NRAs, is considered to be appropriate. ANACOM therefore considers that the methodology<sup>14</sup> used so far to determine the tax rate in previous years should continue to be applied, which corresponds to the sum of values of each of its constituent components (currently, the corporate income tax rate, the State surtax rate and the municipal surtax rate), obtained by applying the methodology described below:

- i) The corporate income tax (IRC) rate should correspond to the IRC rate in force in the financial year for which the cost-of-capital is being determined. In this sense, and taking into account the methodology described above, which establishes the use of the

<sup>11</sup> The BEREC report mentions that it has taken the UK into consideration as it was an EU Member State until 31 January 2020.

<sup>12</sup> According to §29 of the Commission Notice: "The Commission considers the arithmetic average method the most appropriate for estimating WACC parameters. Firstly, using a single averaging method is likely to be more transparent for stakeholders than combinations of several methods."

<sup>13</sup> §60 refers as follows: "The Commission considers it appropriate to use the relevant domestic corporate tax rate, which is the common approach adopted by NRAs, to estimate the pre-tax WACC."

<sup>14</sup> For further details on the methodology, *vide* the document "Final decision about the cost-of-capital rate for MEO – Serviços de Comunicações e Multimédia, S.A. (2018 financial year)", available at [https://www.anacom.pt/streaming/DecisaoFinal\\_09052019\\_WACC\\_MEO2018.pdf?contentId=1471758&field=ATTACHED\\_FILE](https://www.anacom.pt/streaming/DecisaoFinal_09052019_WACC_MEO2018.pdf?contentId=1471758&field=ATTACHED_FILE)



nominal IRC rate in force for 2020, ANACOM believes that the tax rate (IRC) to be considered should be 21%;

- ii) The State surtax rate, due to the legislative alterations that have occurred in recent years, is now determined on a progressive basis according to the company's taxable profit, which corresponds to the rate resulting from applying the legislation in force for the applicable year of the capital cost to the average of positive taxable profits in the three years preceding the year of application.

In this regard, it should be noted that the analysis of the MEO Reports and Accounts for the financial years of 2017, 2018 and 2019 showed that a taxable profit and consequent payment of state surcharge for the financial year in question only occurred in the 2018 financial year.

As mentioned earlier, the State surtax rate is determined on a progressive basis according to the company's taxable profit, being levied, in 2020, a 3% rate on profit exceeding €1 500 000 and up to € 7 500 000 euros, a 5% rate on taxable profit between €7 500 000 and € 35 000 000, and a 9% rate on taxable profit in excess of €35 000 000<sup>15</sup>.

Therefore, as the State surtax is determined by applying the rate resulting from the legislation in force to the average of positive taxable profits in the three years prior to the year of application, and given that in the above-mentioned three-year period taxable profits were recorded only for the 2018 financial year, the state surtax will result from applying rates in force to the taxable profit established for the 2018 financial year.

**Table 6: MEO's taxable profit (2017-2019)**

Year	Taxable profit (Thousand Euro)	Effective State surtax rate (Thousand Euro)
2017		
2018	445.108	38.465
2019		
<b>Average</b>	445.108	38.465

**Source:** State surcharge value according to MEO's model 22.

<sup>15</sup> Article 87-A of the IRC Code, as amended by Law No. 114/2017, of 29 December.

As such, in light of the methodology described above, ANACOM considers that the State tax rate to be considered in the calculation of the cost-of-capital, for 2020, should incorporate a state surtax of 8.64% (*vide* Table 7).

**Table 7: State surtax rate**

Taxable Profit Range	State Surtax Rate	Taxable profit (thousand Euro)	State Surtax (thousand Euro)	Average State surtax rate
Up to €1.500.000	0%	1500	0	
Between €1.500.000 and €7.500.000	3%	6.000	180	
Between €7.500.000 and € 35.000.000	5%	27.500	1.375	
Over €35.000.000	9%	410.108	36.910	
		(1) 445.108	(2) 38.465	(2)/(1) 8.64%

**Source:** Calculations performed by ANACOM on the basis of information provided by MEO.

- iii) As regards the municipal surtax, as this is a parameter exogenous to the company in the sense that it does not result from taxable profits in each year, the established methodology determined that, on account of the widespread location of municipalities with different municipal surtax rates<sup>16</sup>, and in order to simplify the process of calculation and determination of its value, the municipal surtax corresponds to the maximum value established in law for municipal surtax rates levied on taxable profit for the 2020 financial period, thus corresponding to 1.50%.

Accordingly, in the light of the above and under the established methodology, ANACOM takes the view that the tax rate, to be considered in the calculation of the cost-of-capital rate applicable in 2020, should be 31.1417% (*vide* Table 8).

<sup>16</sup> Tax and Customs Authority Letter No. 20218 of 2020-02-19 on IRC - municipal surtax rates levied on taxable profit for the 2019 tax period, available on the website [https://info.portaldasfinancas.gov.pt/pt/informacao\\_fiscal/legislacao/instrucoes\\_administrativas/Documents/Oficio\\_circulado\\_20218\\_2020.pdf](https://info.portaldasfinancas.gov.pt/pt/informacao_fiscal/legislacao/instrucoes_administrativas/Documents/Oficio_circulado_20218_2020.pdf)

**Table 8: Tax rate**

Tax rate	
Article 87 of IRC Code - IRC Tax Rate	21.00% <sup>17</sup>
Article 87-A of IRC Code - State Surtax Rate	8.6417%
Municipal surtax	1.50%
	31.1417%

### 2.2.7. Definition of the cost-of-capital rate

The prior adoption of a clear methodology and the resulting *a priori* specification of the cost-of-capital rate promotes regulatory predictability and transparency in markets.

Therefore, and taking into consideration the parameter values obtained, detailed in the aforementioned BEREC report and presented in the previous points, ANACOM believes that the **cost-of-capital rate** applicable to 2020 should be **7.1077%** (*vide* Table 9).

**Table 9: Cost-of-capital rate (2020)**

Parameters	
Risk-free interest rate	2.1600%
<i>Beta</i>	0.7921
Risk premium	5.3100%
Gearing	36.9507%
Debt premium	1.3000%
Tax rate	31.1417%
Cost of equity	6.3663%
<b>Cost-of-capital rate (2020)</b>	<b>7.1077%</b>

<sup>17</sup> According to the information available on 13.07.2020 on the website of the Tax and Customs Authority [https://info.portaldasfinancas.gov.pt/pt/informacao\\_fiscal/codigos\\_tributarios/CIRC\\_2R/Pages/circ-codigo-do-irc-indice.aspx](https://info.portaldasfinancas.gov.pt/pt/informacao_fiscal/codigos_tributarios/CIRC_2R/Pages/circ-codigo-do-irc-indice.aspx)

### 3. Conclusion

In view of results of the various parameters required to calculate the cost-of-capital rate, this Authority hereby determines that, in the context of the 2020 results of MEO's cost accounting system, a **cost-of-capital rate of 7.1077%** shall be used.