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Autoridade Nacional de
Comunicações (ANACOM)
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P-1099-017 Lisboa
Portugal

For the attention of:
Mr. José Manuel Amado da Silva
Chairman

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Dear Sir,

Subject: **Case PT/2008/0850: Wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location;**

Case PT/2008/0851: Wholesale broadband access;

Comments pursuant to Article 7(3) of Directive 2002/21/EC[1]

I. PROCEDURE

On 4 December 2008 the Commission registered a notification from the Portugese regulatory authority, *Autoridade Nacional de Comunicações* ("ANACOM"), concerning the review of the markets for **wholesale (physical) network infrastructure access (including shared or fully unbundled access) at a fixed location** (market 4 of the Recommendation on relevant markets[2]) and for wholesale broadband access (market 5 of the Recommendation).

Pursuant to Article 6 of the Framework Directive, the national consultation took place between 30 June and 11 August 2008.

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1 Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services, OJ L 108, 24.4.2002, p. 33 (the "Framework Directive").

2 Commission Recommendation 2007/879/EC of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, (the "Recommendation") OJ L 344, 28.12.2007, p. 65.

On 10 December 2008 the Commission sent a request for information to ANACOM and a reply was received on 15 December 2008. ANACOM provided further clarification on 18 December 2008.

Pursuant to Article 7(3) of the Framework Directive, national regulatory authorities ("NRAs") and the Commission may make comments on notified draft measures to the NRA concerned.

II. DESCRIPTION OF THE DRAFT MEASURE

II.1. Previous notification

The first review of these markets was conducted under cases PT/2004/0117 concerning the market for local loop unbundling ("LLU") and PT/2004/0118 concerning the wholesale broadband access ("WBA") market.

At the time, in the market for LLU, ANACOM designated PT Comunicações S.A. ("PTC") as having SMP and imposed regulatory obligations on it[3]. The Commission had a comment on the costing methodology for the implementation of the price control obligation calling on ANACOM to consider whether the FL-LRIC (forward looking long run incremental cost) methodology would not be more appropriate than the FDHC (fully distributed historic costs) methodology.

As regards the market for WBA, ANACOM found that PT Group had SMP in the market and imposed the whole set of regulatory obligations. The Commission made a comment on the inclusion of wholesale broadband access via the cable network in the relevant product market, but noted that in this particular case its exclusion from the relevant product market would not have led to a different result in the SMP analysis.

II.2. Market definition

II.2.1. Market 4: Wholesale network infrastructure access at a fixed location

ANACOM concludes that the relevant product market for (physical) access to network infrastructure at the wholesale level (including partially or completely unbundled access) at a fixed location covers all access products irrespective of the supporting technology.

ANACOM arrives at the conclusion that cable products should be included in the product market definition due to indirect constraints stemming from the retail level. According to ANACOM, the proportion of the LLU wholesale price in the retail price is 50% and a small but significant non-transitory price increase (10%) in LLU would be reflected in approximately a 5% price increase in the retail price. As a consequence, it considers that end users would switch to cable to an extent that would make the wholesale price increase unprofitable. ANACOM acknowledges, however, that the indirect constraints in the case of LLU are weaker than for WBA mainly due to the lower weight of the wholesale input price in the retail price.

In a clarification provided to the Commission on this market on 18 December 2008, ANACOM notes that it includes fibre products in the market definition. Two alternative

[3] These included the following: (i) to provide access to and use of specific network facilities; (ii) non-discrimination; (iii) transparency; (iv) accounting separation; (v) price controls and cost accounting; and (vi) to provide accounting information in order to enable the NRA to control the fulfilment of the four latter obligations.

operators have already launched fibre-based products in Portugal[4] and PT also has some trials underway. ANACOM also commits to closely follow the development of this technology in relation with broadband markets and explains that it has recently launched a public consultation about conditions governing access to NGA. The forthcoming publication of the ensuing report and guidance is expected to enhance regulatory certainty. ANACOM furthermore mentions that a Council of Minister's Resolution of 30 July 2008 has determined that ANACOM should identify any access and construction barriers to ducts and critical infrastructure of all relevant entities, and to propose appropriate measures (legislative or others) to remove those barriers and to evaluate and propose solutions to eliminate or diminish vertical barriers to the installation of fibre, as well as solutions for sharing/mutualisation of building infrastructure, in order to prevent the monopolisation of access to buildings. ANACOM is to formalise its proposals in the form of draft legislation which is expected to be finished in the first quarter of 2009.

ANACOM concludes that fixed wireless access ("FWA") broadband access products are not included in the market.

ANACOM concludes that the relevant geographical market for unbundled access is national.

II.2.2. Market 5: Wholesale Broadband Access ("WBA")

Product market definition

ANACOM concludes that wholesale broadband access via copper (including self supply) and cable modem belong to the same relevant market. As for the LLU market, fibre products are included while broadband wireless access products are excluded.

As regards the substitution with cable-based wholesale broadband services, ANACOM analyses both direct and indirect constraints. In terms of direct constraints, ANACOM explains that there is no wholesale broadband access product based on cable in the market. However, ANACOM states that in Portugal cable penetration is significant[5] and the share of retail broadband access via cable is high[6] compared to other European countries. It considers that the non-inclusion of cable-based broadband services would result in a rather narrow definition of the relevant wholesale market.

ANACOM also examines indirect constraints. Regarding indirect price constraints ANACOM addresses the question of whether a small but significant price rise on the wholesale market from a hypothetical monopolist of WBA via DSL leads to significant substitution at the retail level from DSL to cable such that the wholesale price increase will not be profitable. ANACOM explains that the percentage of the wholesale price of the wholesale bitstream offer "Rede ADSL PT" in the retail price varies between 60% and 70%. ANACOM argues that if the WBA price were to increase by 10%, this would lead to an increase of 6% to 7% of the retail price. ANACOM further emphasises that the elasticity of the demand at the retail level is high[7], and that the barriers to switching are

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4 Sonaecom and TVTel. On 20.02.2008, Sonaecom made an announcement regarding investment plans of €140 million in next generation networks in three years covering a million households.

5 Around 73% of the households are covered by cable networks.

6 Around 35%.

7 In this respect ANACOM refers to the European Customer Satisfaction Index (ECSI) 2007 report for Portugal which found that 16% of users would be willing to switch to another broadband offer in response to a 0 to 20% price increase and also to a working paper from Pereira, P. and Ribiero T., which suggests that cross-price elasticity between DSL and cable broadband services is high in Portugal.

reasonably low. ANACOM also observes a tendency for increased retail competition between DSL and cable-based broadband offers following the spin-off of the main cable operator, ZON Multimedia, from the PT Group[8]. Therefore, it considers that a price increase at the wholesale level for DSL would turn out to be unprofitable. Thus, ANACOM concludes that offers supported on ADSL and cable can be included in the same market.

ANACOM also includes self-supply by LLU operators in the relevant market on the basis of indirect constraints[9].

Geographical segmentation

ANACOM observes that market developments, namely the development of unbundling[10], the entrance of new operators, the spin-off of ZON Multimédia and the expansion of the cable network coverage area suggest that the competitive conditions are no longer homogeneous in the national territory. ANACOM furthermore provides evidence of changing competitive conditions with reductions in retail prices[11] as well as differentiated retail prices and product offers being provided on a geographical basis[12].

In order to obtain information on the competitive conditions in the market ANACOM adopts the Main Distribution Frame ("MDF") area as the relevant geographical unit due to competitive conditions being more homogenous in these areas than on a municipality basis and also in recognition of LLU as a key driver of competition in this market[13]. Having analysed pricing and product trends as well as market shares in each MDF area ANACOM observed that competitive pressures are strongest in areas covered by cable networks and where there are LLU operators. The MDFs were grouped together taking into account the existence and the number of co-located and cable operators in the municipality where the respective MDF is located. As a result, ANACOM came to the conclusion that the greater the number of operators in an MDF area, the smaller the

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8 Zon Multimédia was formerly part of the incumbent PT Group.

9 In this respect, ANACOM also notes that PT's retail prices have been decreasing due to competitive pressure from LLU operators.

10 At the end of 2007, 60% of the population was covered by LLU.

11 According to ANACOM, retail prices have fallen significantly since 2004, especially in classes with higher speeds, and there are offers where the monthly payment is equal to or even below the previously available offerings (which provided lower speeds). For example, in 2004 the LLU operator, Sonaecom, marketed the “Opção Livre” option with a descending speed of 1024 Kbps for which the final client paid a monthly instalment of €32,69. An offering which is currently available is the “Clix 24Mb” which allows a maximum descending speed that is 24 times superior (24 Mbps) and for which the final client pays practically the same monthly instalment, i.e. €32,98. Cable retail offerings have also witnessed improvements. In 2004, the “NetCabo 512” product offered a maximum downlink speed of 512 Kbps for a monthly cost of €29,41 while the current “NetCabo Plus" offer allows a maximum downlink speed of 12 Mbps (i.e. 20 times higher) for a monthly cost of identical value, i.e. €29,41.

12 PT Group recently launched a naked DSL product which is mainly available in LLU areas. Offers of other operators in the LLU/cable areas have superior characteristics in terms of functionality and/or price when compared to offers in non-LLU/cable areas. For example, in LLU areas users might have a 24 Mbps product with unlimited calls and 25 TV channels paying almost half the price paid by users in non-LLU areas for an 8 Mbps product with no TV channels. In cable-covered areas the price of broadband offers by cable operators are 33% lower than in non-cable covered areas (where the cable operator relies on bitstream).

13 Retail offers based on LLU were responsible for more than 50% of new broadband accesses registered between the end of 2006 and 2007.

market shares of PT at that MDF. Similarly, ANACOM observed a (negative) correlation between the percentage of cabled households and PT's market shares at a given MDF.

Taking into consideration the above, ANACOM identifies two relevant geographical markets:

(i) a competitive or "C" area = areas covered by an MDF where there is at least one co-installed (LLU) operator and at least one cable operator, and where the cable penetration of the MDF is above 60%[14]. Thus the "C" area comprises of 184 MDF areas which account for 61% of the total broadband accesses[15];

(ii) non-competitive or "NC" areas = all other areas.

II.3. Significant market power ("SMP") assessment

2.3.1. Market 4: Wholesale network infrastructure access at a fixed location

ANACOM concludes that PT Group has SMP in the market for (physical) access to network infrastructure at the wholesale level in a fixed location on the basis of *inter alia* the following criteria: market shares[16], barriers to entry and expansion[17] and the lack of potential competition.

2.3.2. Market 5: Wholesale Broadband Access ("WBA")

In "C" areas (i.e. 184 MDFs), ANACOM intends not to designate any operator as having SMP.

ANACOM considers *inter alia* the evolution of market shares. PT Group's wholesale market shares have decreased on average from 41% in 2005 to 27% in 2007, ZON Multimédia's market shares have also decreased from 39% to 33%, Sonaecom's market shares have increased significantly from 8% in 2005 to 25% in 2007, while Cabovisao's market share has remained stable at 10%. The total of all other operators' market share is as low as 4%.

In "NC" areas (i.e. all other MDF areas), ANACOM intends to designate PT Group as having SMP. In these MDFs, PT Group's market shares have decreased only slightly from 75% in 2005 to 72% in 2007, ZON Multimédia's market share has remained stable at 12%, Sonaecom's market share has increased from 1% in 2005 to 5% in 2007, while Cabovisao's market share has remained stable at 10%. The total of all other operators' market share is only 2%.

Other criteria assessed by ANACOM in both areas are: potential competition, barriers to entry and expansion, economies of scale and scope, vertical integration, trends of prices, international benchmarking, evidence of previous anti-competitive behaviour and countervailing buyer power.

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[14] ANACOM concluded that by using an indicator of 60% of cabled households per MDF, the homogeneity of market shares at MDFs can be maximized.

[15] Out of the 184 MDFs in the "C" area, PT Group has a market share in excess of 50% at 12 (which represent 1,7% of all broadband lines) MDFs.

[16] In 2007 PT Group had a market share of 64 %, ZON Multimédia had 26%, Cabovisao 7% and other operators had 2% (including self-supply). If self-supply is excluded, PT Group's market share would be 100%.

[17] Including sunk costs and economies of scale and scope.

II.4. Regulatory remedies

II.4.1. Market 4: wholesale network infrastructure at a fixed location

ANACOM intends to maintain the existing remedies on PT Group and indicates the possibility of supplementing them in order to include access to the fibre access network and migration rules relating to the transition from copper to fibre:

- Access to and use of specific network facilities;
- Possibility to impose access to dark fibre when access to ducts is not possible. Possibility to impose access obligation to optic fibre, by means of a subsequent decision, in the framework of the roll-out of NGA networks[18];
- Transparency in the publication of information, including reference offers, an obligation to provide other operators with detailed and timely information about the evolution of the access network;
- Non-discrimination in relation to access and interconnection (including related information);
- Accounting separation in relation to specified activities related to interconnection and/or access;
- Price control and cost accounting[19];
- Obligation to submit financial report.

II.4.2. Market 5: Wholesale Broadband Access ("WBA")

<u>Obligations in "NC" areas</u>

ANACOM intends to maintain the existing remedies on PT Group and mandate additional obligations (naked DSL and the amendment of transparency obligations):

- Access to and use of specific network facilities – including access to a Naked DSL offer;
- Transparency in the publication of information, including reference offers;
- Non-discrimination in relation to access and interconnection (including related information);
- Accounting separation in relation to specified activities related to interconnection and/or access;
- Price control and cost accounting;
- Obligation to submit financial report.

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18 Subject to further decision in that respect.

19 For the purpose of price regulation of unbundled access to the local loop and related facilities ANACOM uses the information from the SMP operator cost accounting model, which is a fully distributed historic costs ("FDHC") model. It is based on an activity based costing (ABC) methodology. ANACOM also uses other price references and international benchmarks. It notes its observation that it is among the countries with the lowest prices for LLU access in the EU.

Obligations in "C" areas

Obligations will be lifted. The price control obligation will be phased out immediately upon the adoption of the decision. The other obligations will be phased out after a transitory period of 12 months.

III. COMMENTS

On the basis of the notification and the additional information provided by ANACOM, the Commission has the following comments[20]:

Inclusion of cable in market 4 on the basis of indirect constraints

Firstly, the Commission notes that – to its knowledge – cable cannot be unbundled, therefore ruling out the possibility of direct wholesale substitution with copper loops. Despite this, and unlike other NRAs, ANACOM nonetheless intends to include cable in market 4 on the basis of indirect constraints.

ANACOM notes that the share of the LLU price in the retail price is 50%. ANACOM assumes that in case of a small but significant non-transitory increase in price ("SSNIP") (10%) the retail price of the broadband access would increase by 5%, and as a result end users would switch to cable-based access products to such an extent as to make the price increase unprofitable.

In relation to the arguments put forward by ANACOM in this respect, the Commission has the following concerns. ANACOM has not provided sufficient justification as to why a price increase would be entirely passed through to the end users of retail broadband access products or that sufficient demand substitution would take place at the retail level to render that price increase unprofitable, in particular because an LLU price increase could affect other retail products, such as voice telephony and IPTV as well. Moreover, it is doubtful that competitors would not be able to at least partially absorb the 10 % price increase in their margins. An incomplete pass-through of this price increase would further weaken the substitution effect at the retail level.

For these reasons, the Commission is of the view that cable should not be included in the market definition as its inclusion leads to an overstatement of the competitive constraints on LLU. However, as ANACOM has carried out the SMP analysis both with and without the inclusion of cable, and since the regulatory outcome is not affected, the Commission does not wish to challenge ANACOM's finding this time, but strongly urges ANACOM not to include cable in market 4 in the final measure.

Inclusion of self-supply in market 5 on the basis of indirect constraints

ANACOM bases its inclusion of cable- and LLU-based WBA services in the relevant market on indirect price pressure from the underlying retail markets.

Repeating its arguments set out regarding the inclusion of cable in market 4, ANACOM notes that the share of the WBA price in the retail price is approximately 60-70%. ANACOM assumes that in case of a SSNIP (10%) the retail price of the broadband access would increase by 6%-7% and as a result end users would switch to cable-based access products to such an extent as to make the price increase unprofitable.

[20] In accordance with Article 7(3) of the Framework Directive.

The Commission has previously noted that competition at the retail level from vertically integrated undertakings may be such as to exert an indirect constraint on the market for wholesale access services and that such indirect pricing constraints, where they are found to exist, should be taken into account in the context of the SMP assessment. As already underlined by the Commission in the context of previous cases, it is essential that the strength of the constraint posed by vertically integrated companies is correctly estimated in the assessment and the Commission has set out appropriate criteria against which the nature of such indirect substitution effects may be assessed[21].

In relation to the arguments put forward by ANACOM in this respect, the Commission highlights that ANACOM has not provided sufficient justification as to why a price increase would be entirely passed on to the end users of retail broadband access products and that competitors would not be able to at least partially absorb this price increase in their margins. At the same time, however, the Commission notes ANACOM's arguments regarding the extensive penetration of cable networks, the increasing presence of LLU operators in Portugal and the changing competitive dynamics at the retail level in terms of the prices and products offered.

Thus, while such indirect constraints influence the geographic boundaries drawn by ANACOM in its analysis, the geographic variations in competitive conditions stemming from the presence of these constraints would still have been identified in the course of the overall competitive assessment (irrespective of whether that took place in the market definition or market power assessment). Furthermore, the Commission notes that ANACOM takes indirect constraints from cable into account in its market definition only for those MDF areas where it considers its presence capable of exercising a sufficient competitive constraint. Thus, in view of this approach, even if indirect constraints were taken into account in the market power assessment rather than in the market definition, this would not have led to a significantly different outcome than that currently being proposed by ANACOM. Consequently, the Commission considers that since a conclusion on whether such constraints should be taken into account in the definition of the relevant market or for the purposes of SMP assessment is not relevant in terms of the regulatory outcome, this question could be left open this time.

Monitoring of trend towards effective competition

As noted above, there is an overall trend towards competition in respect of the majority of exchanges included in ANACOM's proposed area "C". In that respect, LLU roll-out is relatively advanced; the LLU-based operator, Sonaecom, has been able to gain market share rapidly; there is evidence of decreasing prices and improved product functionalities; and there is market share decline on the part of PT Group which would indicate that the market is becoming competitive. Furthermore, the development of LLU coverage and competition would also appear to be reaching a stage whereby it may be reasonable to infer that the proposed market boundaries will remain relatively stable over the timeframe of this review.

However, the detailed evidence provided by ANACOM at the MDF level showed that for certain MDFs in the proposed area "C" the competitive dynamic may be somewhat different. In particular, at 12 MDFs (representing 1,7% of total broadband access lines in

[21] Explanatory Note to the Commission Recommendation on Relevant Product and Service Markets within the electronic communications sector susceptible to *ex ante* regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services (C(2007) 5406), pp. 34-35. See also cases UK/2003/0032, NL/2005/0281, AT/2005/0312, and UK/2007/0733.

Portugal) PT Group's market share at the retail level was still at or above 50% in 2007 and ANACOM was not able to demonstrate a downward trend in the market shares. According to the data provided by ANACOM, the market share of PT Group has in most of these MDFs slightly decreased or has remained stable in the period of 2005-2007. According to the SMP guidelines, this is in itself an indication of dominance save for exceptional circumstances.

ANACOM mentions that in the majority of these MDFs the co-location of alternative operators happened only recently (in the second half of 2007 and the beginning of 2008), which in part could explain the relatively low market share of LLU operators. It also states that in these areas entry barriers are low as is also the case for other MDFs in the "C" area, and that they are located in densely populated areas. ANACOM adds that the prices of retail products provided by alternative operators and by PT are the same as in the case of other MDFs in the "C" areas which exhibit a sufficient level of competition.

Based on this information, on the rapid evolution of unbundling in Portugal and on the market share trends observed in the other "C" areas to date, the Commission is of the view that it can be reasonably expected that the trend towards effective competition in these MDF areas is likely to further increase. In addition, the Commission notes that the existing regulation in those exchanges will be maintained for a transitional period of one year.

In the light of the above, the Commission invites ANACOM to carefully monitor the progression of competition and to update its market analysis in respect of these 12 MDFs before the expiry of the 1-year transitional period, in order to confirm the anticipated tendencies, to reconsider its decision to de-regulate those MDFs that do not follow the predicted competitive trend, and to conduct a further market review if that is not the case.

Regulation of fibre in market 4 and 5

First, the Commission request ANACOM to clearly indicate in the final measure, in line with the information provided on 18 December 2008 that fibre is included in the relevant markets.

Furthermore, the Commission notes that ANACOM does not impose any obligations on fibre at this stage. As explained by ANACOM, these obligations will be further detailed/specified in a subsequent decision, to be adopted in the framework of the roll-out of NGA networks, and which is preceded by a currently ongoing consultation on the market. In this respect, the Commission also acknowledges that there is an operational duct access obligation in Portugal, and that ANACOM is working on legislative proposals with regard to issues related to NGAs.

However, the Commission draws attention to the fact that fibre-based access products are already in the market in Portugal, and that PT Group is already in the process of rolling out fibre (at least for the purpose of carrying out trials). It is also important to note that fibre roll-outs may significantly change the competitive landscape, especially if MDFs will be closed down. Even as early as in the phase of announcements and planning, these developments may be liable for halting competitive tendencies. This is especially relevant in the Portuguese situation where the competitiveness of the retail broadband market and the WBA market are – to a large extent – conditioned by the availability of sufficient inputs in the LLU market. Should wholesale inputs in market 4 necessary to compete on the retail market become unavailable, the competitive tendencies might well be reversed.

In the light of the above, the Commission invites ANACOM to impose remedies on fibre access products as appropriate following the national NGA consultation. The Commission notes that ANACOM foresees the possibility of imposing obligations on fibre access in the near future in market 4. Furthermore, the Commission invites ANACOM to carefully examine the need for the imposition of access remedies also in market 5. Such draft measures concerning the regulation of NGAs need to be notified in line with Article 7 of the Framework Directive.

In this context, the Commission also underlines the need for ANACOM to closely monitor the overall level of wholesale competition and the provision of wholesale broadband access services in Portugal to ensure that both business and residential users are adequately protected by effective wholesale competition over the timeframe of its review.

Finally, the Commission highlights that it is necessary to provide further guidance in the context of the NGA roll-out in order to ensure legal certainty for investors and to prevent undesirable divergences of regulatory approaches in the internal market. To this end, the Commission services are working towards a Recommendation on NGA remedies so that a consistent regulatory approach will be applied to such networks across the EU. In the light of this, the Commission invites ANACOM to revisit its analysis when carrying out its next review along the lines of this Recommendation once adopted.

Pursuant to Article 7(5) of the Framework Directive, ANACOM shall take the utmost account of comments of other national regulatory authorities and the Commission and may adopt the resulting draft measure and, where it does so, shall communicate it to the Commission.

The Commission's position on this particular notification is without prejudice to any position it may take *vis-à-vis* other notified draft measures.

Pursuant to Point 15 of Recommendation 2008/850/EC[22], the Commission will publish this document on its website. The Commission does not consider the information contained herein to be confidential. You are invited to inform the Commission[23] within three working days following receipt whether you consider that, in accordance with Community and national rules on business confidentiality, this document contains confidential information which you wish to have deleted prior to such publication. You should give reasons for any such request.

Yours faithfully,
For the Commission,
Fabio Colasanti
Director-General

[22] Commission Recommendation 2008/850/EC of 15 October 2008 on notifications, time limits and consultations provided for in Article 7 of Directive 2002/21/EC, OJ L 301, 12.11.2008, p. 23.

[23] Your request should be sent either by email: INFSO-COMP-ARTICLE7@ec.europa.eu or by fax: +32.2.298.87.82.