EUROPEAN COMMISSION

Brussels, 6.6.2018
C(2018) 3740 final

Autoridade Nacional de
Comunicações (ANACOM)

Avenida José Malhoa No. 12
P-1099-017 Lisboa
Portugal

For the attention of:
Mr. João Cadete de Matos
Chairperson

Fax: +351 21 721 10 02

Dear Mr. Cadete de Matos,

Subject: Commission Decision concerning Case PT/2018/2076: wholesale voice call termination on individual mobile networks in Portugal

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

1. PROCEDURE

On 7 May 2018, the Commission registered a notification from the Portuguese national regulatory authority, Autoridade Nacional de Comunicações (ANACOM)[1], concerning wholesale voice call termination on individual mobile networks[2] in Portugal.

The national consultation[3] ran from 22 January 2018 to 5 March 2018.

---

1 Under Article 7 of 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 (Framework Directive), OJ L 108, 24.4.2002, p. 33, as amended by Directive 2009/140/EC, OJ L 337, 18.12.2009, p. 37, and Regulation (EC) No 544/2009, OJ L 167, 29.6.2009, p. 12.

2 Corresponding to market 2 in Commission Recommendation 2014/710/EU of 9 October 2014 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 (Recommendation on Relevant Markets), OJ L 295, 11.10.2014, p. 79.

3 In accordance with Article 6 of the Framework Directive.

On 17 May 2018 a request for information (RFI)[4] was sent to ANACOM and a response was received on 22 May 2018. On 24 May 2018 a supplementary RFI was sent to ANACOM and a response was received on 25 May 2018.

2. DESCRIPTION OF THE DRAFT MEASURE

2.1. Background

The market for wholesale voice call termination on individual mobile networks in Portugal was previously notified to and assessed by the Commission under case PT/2015/1763[5].

ANACOM identified six relevant wholesale markets for mobile voice call termination on the networks of six undertakings (including both mobile network operators and mobile virtual network operators)[6], and found that the geographic scope of each market coincided with the geographic coverage of each network. ANACOM designated these operators with significant market power (SMP), and imposed on them the following obligations: (i) access, (ii) non-discrimination in the provision of interconnection and in the respective provision of information, (iii) transparency in the publication of information and, (iv) price control. The previously imposed obligations of accounting separation and cost accounting ceased to apply (PT/2010/1058).

The European Commission had no comments.

2.2. Market definition

ANACOM defines the market for wholesale voice call termination on mobile networks as including the provision of wholesale voice call termination services by mobile network operators and mobile virtual network operators[7], encompassing termination of all voice calls, regardless of the type of network or of the entity originating the calls.

The geographic scope of each market coincides with the geographic coverage of each terminating network.

[4] In accordance with Article 5(2) of the Framework Directive.

[5] C(2015)1763

[6] ANACOM designated the following operators with SMP: CTT - Correios de Portugal, S.A. (CTT); Lycamobile Portugal, Lda (Lycamobile); MEO - Serviço de Comunicações e Multimédia, S.A. (MEO); Mundio Mobile (Portugal) Limited (Mundio); NOS Comunicações, S.A. (NOS); Vodafone Portugal - Comunicações Pessoais, S. A. (Vodafone).

[7] ANACOM designates the following operators with SMP in the market under review: CTT; Lycamobile; MEO; Vectone Mobile (Portugal) Limited (Vectone); NOS; NOWO Communications, SA (NOWO); OniTelecom - Infocomunicações, S.A (ONI); Vodafone.

2.3. Finding of significant market power

ANACOM considers that all providers of voice call termination services on individual mobile networks in Portugal[8] should be designated with SMP in their respective mobile termination market.

ANACOM based its conclusion on the following: (i) each provider has a market share of 100% in the provision of call termination services on its own mobile network, (ii) high barriers to market entry persist, (iii) lack of significant countervailing buyer power, (iv) termination rates have decreased solely as a result of regulatory intervention. ANACOM concludes that in the absence of *ex-ante* regulation, operators have the ability and incentives to act independently of competitors and consumers in this particular market.

2.4. Regulatory remedies

ANACOM proposes to maintain the following obligations: (i) access, (ii) non-discrimination and the respective provision of information, (iii) transparency in the publication of information and (iv) price control.

Based on a review of ANACOM's pure BU-LRIC model, the new price cap for mobile call termination is proposed to be set at 0.45 eurocents per minute[9], and to enter into force 10 days after the notified decision has been adopted. With a view to ensure regulatory certainty, ANACOM also proposes to set the price caps for 2019 and 2020 by updating the proposed MTR model for inflation[10].

Finally, ANACOM proposes to maintain the non-application of the price cap for traffic originating outside the European Economic Area (EEA). Such exemption does not apply to operators or countries that practice national termination charges equal or lower than the regulated prices charged by providers in Portugal to traffic originated in the EEA. In such cases, the termination prices of voice traffic charged by SMP providers should not exceed the regulated price.

2.4.1. WACC

In the notified measure, ANACOM sets the Weighted Average Cost of Capital (WACC) at a level of 10.48%. However, after reviewing the calculation of some of the WACC parameters in response to the second RFI, ANACOM identified a calculation error in the beta parameter of the WACC formula and committed to set the real pre-tax WACC at the level of 6.09% instead[11], as described in the table below.

---

[8] CTT, Lycamobile, MEO, Vectone Mobile, NOS, NOWO, OniTelecom and Vodafone.

[9] The proposed MTR of 0.45 eurocents per minute was subsequently changed to 0.42 eurocents per minute in response to the change in the WACC parameter, see section 2.4.1.

[10] The 2019 and 2020 price caps are expected to enter into force on 1 July 2019 and 1 July 2020, respectively, which would be preceded by ANACOM's publication of the new prices on its webpage in the first quarter of the given year.

[11] The change in the WACC from its previous level of 10.48% to the new level of 6.09% is due to the change in the equity beta from the original level of 1.89 to the new level of 0.82.

Parameters and values used by ANACOM to calculate the WACC

Risk-free rate, nominal	2.80%
Equity premium	7%
Beta (relevered for gearing and tax)	0.82
Unlevered beta	35%
Nominal cost of equity (post-tax)	8.54%
Nominal cost of equity (pre-tax)	12.12%
Nominal cost of debt (pre-tax)	4.32%
Debt premium over risk free rate	1.5%
Gearing (D/D+E)	57.6%
Debt over equity (D/E)	135.67%
Marginal tax rate	29.50%
Nominal WACC (pre-tax)	7.63%
Inflation rate	1.45%
Real pre-tax WACC	**6.09%**

ANACOM uses a 'country-specific' approach for the calculation of three WACC parameters: the risk-free rate (RFR, based on the yield of Portuguese government bonds), the equity risk premium (ERP, based on the average of three studies that determine the ERP level for Portugal) and the tax rate (the Portuguese marginal tax rate). In contrast, it adopts a 'notional' approach for the calculation of the four other WACC parameters – beta, gearing, cost of debt and inflation – for which the calculation is based on values determined by other NRAs and/or data from electronic communications operators active in other EU countries.

In addition, ANACOM uses different averaging periods for the calculation of the RFR (2 years), beta (1 year), gearing (5 years), inflation (10 years) and cost of debt (via a benchmark of observations in EU countries spanning from 2014 to 2017).

Finally, for the calculation of the beta and gearing, ANACOM relies on data from a peer group of five telecoms operators[12].

3. COMMENTS

The Commission has examined the notification and the additional information provided by ANACOM and has the following comments:[13]

Considerations regarding the determination of the WACC

The WACC is an important parameter in the calculation of the wholesale prices applied in the markets subject of the current notifications. NRAs are bound, pursuant to Article 8 of the Framework Directive as well as Articles 13(1) and (2) of the Access Directive, to impose a cost orientation obligation that meets the objectives of encouraging efficient investments, including in next generation

12 The peer group includes: Mobistar (now Orange), Telenor, TeliaSonera, Vodafone and Mobile Telesystems. ANACOM argues that, for consistency reasons, it maintains the same reference group used in its 2012 WACC calculation.

13 In accordance with Article 7(3) of the Framework Directive.

networks, and allowing a reasonable rate of return on adequate capital employed, while promoting efficiency and sustainable competition and maximising consumer benefits in terms of choice, price and quality (Article 8(2)a and 8(5)d of the Framework Directive).

Need to update the WACC value in the final measure

The Commission acknowledges ANACOM's commitment to correct the initially notified pre-tax real WACC value of 10.48% following the Commission's questions regarding the unusually high beta value used in the calculations. The Commission requests ANACOM to clearly indicate the new WACC value of 6.09% in its final measure, and apply this value in all relevant cost calculations. The Commission further asks ANACOM to clearly note the resulting new MTR of 0.42 eurocents in the final measure.

Country-specific vs notional approaches

The Commission further notes that ANACOM has used a 'country-specific' approach for the calculation of some WACC parameters (RFR, ERP and the tax rate) while adopting a 'notional' approach for the calculation of other parameters (beta, gearing, cost of debt and inflation).

In the Commission's view, it might be preferable to adopt a 'notional' approach for the calculation of the RFR and ERP. A notional approach for these parameters would be consistent with the fact that investors typically hedge their risk by investing in bonds and shares in different countries, not only in the country in which the regulated operator is based. For instances, the use of a European average would likely result in a lower ERP value compared to the 7% proposed by ANACOM[14]. Indeed, a 2017 report by BEREC[15] calculates an average ERP of 5.77% for a selection of 31 EU and neighbouring countries.

On the other hand, in order to properly account for the specific risk of Portuguese mobile operators which cannot be diversified, it would be more appropriate to calculate the beta, gearing and debt premium of those operators, rather than relying exclusively on a peer group.

Indeed, the beta/debt and premium/gearing of the peer group may fail to capture important elements of the SMP operators' systematic risk (such as specific national demand and/or supply conditions). The Commission is aware that relying solely on the SMP operators' data to estimate these parameters may, however, encompass their potential inefficiencies.

The Commission therefore proposes that ANACOM, at the occasion of the next review of the WACC parameters, uses data specific to the Portuguese SMP operators for the calculation of beta, gearing and debt premium, provided that the relevant information is publicly available. This will accurately reflect the

[14] ANACOM's ERP values for Portugal were calculated on the basis of three studies by: i) Pablo Fernandez, ii) Aswath Damodaran and iii) Dimson, Marsh & Staunton.

[15] BEREC Report Regulatory Accounting in Practice 2017 - https://berec.europa.eu/eng/document_register/subject_matter/berec/reports/7316-berec-report-regulatory-accounting-in-practice-2017

underlying risk of their operations, but the values can then be compared to those of a peer group of telecoms operators, and be adjusted to account for potential inefficiencies.

Consistency of the averaging period

The Commission notes that ANACOM uses different averaging periods for the calculation of the RFR, beta, gearing, inflation and cost of debt. The Commission believes it may be more appropriate to use the same averaging period for all these parameters as to increase the consistency of the WACC estimation. Longer averaging periods are likely to promote greater predictability and stability in the value of WACC parameters and, therefore, of the final WACC value. An averaging period of 5 years would appear to strike the right balance between predictability and efficiency, while also being consistent with the average length of an economic cycle.

The Commission therefore invites ANACOM to revisit the averaging period at the occasion of the next review of the WACC parameters, and, if deemed appropriate, set a 5 year averaging period for the calculation of the RFR, beta, gearing, inflation and cost of debt.

Choice of peer group for the calculation of beta and gearing

The Commission does not dispute that the use of a peer group can provide useful information when assessing the beta and gearing values calculated for the SMP operators. However, the Commission would like to highlight the importance of composing an appropriate, relevant and updated benchmark of operators. It seems suitable to only include in such peer group operators which:

- have an investment grade credit rating (the share prices of firms with lower credit ratings are likely to be more reactive to company-specific factors, which will tend to increase their beta in a way that is not representative of an efficient SMP operator);
- are not involved in any substantial mergers and acquisitions over the period for which data is used to calculate the parameters;
- have shares that are liquidly traded (so that the observed share price incorporates all of the available information at any time);
- own and invest in electronic communications infrastructure, rather than simply rent it (to ensure that the estimated beta is consistent with the systematic risk of an SMP operator that offers access to its infrastructure) [16];
- have their main operations in EU member states.

ANACOM's peer group composition is based on the argument the selected operators are "pure play mobile operators". In the Commission's view, this classification is not accurate (some of the selected operators having multiple activities). While the fixed/mobile convergence trend amid European operators may make it difficult to select a peer group of "pure play" mobile operators, the Commission believes that it is still possible to determine a "mobile" and "fixed" beta for a convergent operator, for example by using beta disaggregation techniques.

[16] This applies irrespective of whether the SMP operator is itself a network owner.

Against this background, the Commission invites ANACOM to revisit the composition of its peer group according to the above mentioned criteria at the occasion of the next review of the WACC parameters and, if deemed appropriate, to adjust its composition. Additionally, the Commission suggests determining the "mobile" beta of the Portuguese mobile SMP operators and of the operators included in the peer group, so that they can be appropriately compared.

Pursuant to Article 7(7) of the Framework Directive, ANACOM shall take the utmost account of the comments of other NRAs, BEREC and the Commission and may adopt the resulting draft measure; 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[17] 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[18] within three working days following receipt whether you consider that, in accordance with EU and national rules on business confidentiality, this document contains confidential information which you wish to have deleted prior to such publication[19]. You should give reasons for any such request.

Yours sincerely,

For the Commission,
Roberto Viola
Director-General

---

[17] 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 of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, OJ L 301, 12.11.2008, p. 23.

[18] Your request should be sent either by email: CNECT-ARTICLE7@ec.europa.eu or by fax: +32 2 298 87 82.

[19] The Commission may inform the public of the result of its assessment before the end of this three-day period.