EUROPEAN COMMISSION

Brussels, 31.8.2018
C(2018) 5876 final

Autoridade Nacional de
Comunicações (ANACOM)
Avenida José Malhoa No. 12
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/2018/2101: Wholesale voice call termination on individual public telephone networks provided at a fixed location in Portugal

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

1. PROCEDURE

On 2 August 2018, the Commission registered a notification from the Portuguese national regulatory authority, Autoridade Nacional de Comunicações (ANACOM)[1], concerning the wholesale voice call termination on individual public telephone networks provided at a fixed location[2] in Portugal.

The national consultation[3] ran from 4 April 2018 to 25 May 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 1 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 10 August 2018 a request for information (RFI)[4] was sent to ANACOM and a response was received on 16 August 2018. On 17 August 2018 a supplementary RFI was sent to ANACOM and a response was received on 20 August 2018.

2. DESCRIPTION OF THE DRAFT MEASURE

2.1. Background

The market for wholesale call termination on individual public telephone networks provided at a fixed location in Portugal was last notified to and assessed by the Commission under case PT/2016/1932[5].

ANACOM concluded that each of the notified product markets comprised the termination services of a single network operator. The relevant market covered fixed voice call termination services, provided at different network levels, independently of the transport and interconnection interface used. The market also included the provision of VoIP (fixed or nomadic) termination services[6] and fixed phone call services provided over GSM/UMTS frequencies (the so-called "homezone" services)[7].

ANACOM identified 18 operators as having SMP on their relevant termination markets and imposed on them access (both TDM and IP), transparency[8], non-discrimination and price control obligations. The non-discrimination and price control obligations were not applicable to calls originated outside the European Economic Area (EEA). Termination services provided at the local and single transit (regional) level were subject to price-caps calculated on the basis of a pure BU-LRIC model (0.0644 €c/minute). As to the rate applicable at the double transit (national) level, ANACOM proposed to leave it to commercial negotiations.[9]

In its comments the Commission urged ANACOM to review the definition of the wholesale fixed call termination markets as soon as possible and set an exact demarcation point between termination and transit markets, in recognition of the state of competition on transit routes beyond the regional/local point of interconnection. In the meantime, the Commission urged ANACOM to lift, in its final measure, the safety caps imposed on tariffs for termination at the national (double transit) level. The Commission also called upon ANACOM to update its cost model (based on 2012 data and a 2014 WACC) without undue delay with a view to ensuring that fixed termination rates in Portugal are forward-looking and set on the basis of the most recent data available.

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

5 C(2016) 7887.

6 Not including Skype-to-Skype.

7 The "homezone" services are offers allowing access to the public telephone network from a fixed location, based on GSM and UMTS technology and network.

8 This obligation includes for the incumbent MEO the requirement to publish a reference offer.

9 In the absence of a commercial agreement, the rates should not exceed 0.1642 €c/minute.

ANACOM subsequently notified to the Commission (case PT/2017/2045[10]) a draft measure concerning the specification of the IP Interconnection obligations, including in particular changes to MEO's Reference Interconnection Offer (RIO). Among other things, the measure set out a migration plan according to which MEO would have six months for implementing the solution for the IP interconnection in its network, with the obligation to migrate 50% of the traffic terminated in its network over the following twelve months; the remaining traffic would have to be migrated in the following six months. The Commission had no comments.

2.2. Market definition

ANACOM defines for each SMP operator a relevant product market comprising fixed voice call termination services, provided at local and regional (single transit) level, independently of the transport and interconnection interface used. The market also includes the provision of VoIP (fixed or nomadic) termination services and the fixed phone call services provided over GSM/UMTS frequency (the so-called "homezone" services). Unlike in the last market analysis, ANACOM proposes to exclude the termination of calls at the double transit (national) level from the relevant market. According to ANACOM, double transit termination represents a small proportion of the traffic terminated in MEO's network and is subject to competitive pressure from transit services provided by alternative operators (deregulated in Portugal since 2005)[11]. In the reply to the Commission's request for information, ANACOM further explains that the impact of this change in the market definition is in practice almost non-existent compared to the current situation.[12]

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

2.3. Finding of significant market power

ANACOM identifies 20 operators as having SMP on their respective fixed termination market[13] based on the analysis of the following criteria: markets shares, price trends and pricing behaviour, barriers to entry and countervailing buyer power.

---

[10] C(2017) 8811.

[11] Moreover, in ANACOM's view double transit services will lose more and more relevance as a consequence of the significant reduction of the number of interconnection points already imposed in the 2016 market analysis in combination with the gradual migration to an all-IP (one-level) network.

[12] Indeed, even though in its final decision of 27 October 2016 ANACOM did not review the market definition notified under case PT/2016/1932 – because it considered that this would have delayed the implementation of the market analysis – it nevertheless fully deregulated the prices of double transit services following the Commission's comment urging ANACOM to lift the safety caps for these services.

[13] AR TELECOM – Acessos e Redes de Telecomunicações, S.A.; Compatel, Limited; COLT Technology Services, Unipessoal, Lda; Dialoga – Servícios Interactivos, S.A.; G9Telecom, S.A.; Gotelecom, Lda.; Greensatellite – Unipessoal, Lda.; IP Telecom, Serviços de Telecomunicações, S.A.; MEO – Serviços de Comunicações e Multimédia, S.A.; NOS Açores Comunicações S.A.; NOS - Comunicações, S.A.; NOS Madeira Comunicações, S.A.; NOWO Communications, S.A.; ONITELECOM – Infocomunicações, S.A.; Orange Business Portugal, S.A.; Pinkhair – Unipessoal, Lda.; VODAFONE PORTUGAL – Comunicações Pessoais, S.A.; VOIP-IT, Lda; VOIPUNIFY TELECOM, Lda; VOXBONE, S.A.

2.4. Regulatory remedies

ANACOM proposes to maintain the following obligations: (i) access; (ii) transparency; (iii) non-discrimination; and (iv) price control[14]. All remedies will apply to all SMP operators, with the exception of the obligation to publish a Reference Interconnection Offer (RIO), which will continue to be imposed only on MEO[15]. The non-discrimination obligation, the obligation to publish prices (as part of the transparency remedy) and the price control obligation are not applicable to calls originated outside the European Economic Area (EEA). However, the price caps mentioned below will apply to calls originated from non-EEA operators charging termination rates equal to or lower than the Portuguese regulated rates[16].

Based on a review of ANACOM's pure BU-LRIC model, the new price cap for fixed call termination is proposed to be set at 0.047 eurocents per minute and to enter into force 10 days after the notified decision has been adopted. With a view to ensuring regulatory certainty, ANACOM also proposes to set the price caps for 2019 and 2020 by adjusting the proposed FTR for inflation[17].

2.4.1. Weighted Average Cost of Capital (WACC)

Among the parameters adjusted in the model update, ANACOM proposes to use a nominal pre-tax WACC of 9.0651% (7.56% in real terms), which corresponds to ANACOM's estimation of MEO's cost of capital for the year 2017[18]. The individual WACC parameters and values are described in the table below.

---

[14] As explained by ANACOM in the reply to the Commission's request for information, the proposed remedies are almost exactly the same as those currently in force, except for the withdrawal of the obligation to give at least two months' advance notice of certain events that could affect interconnection and MEO's obligation to publish quality levels concerning the network of interconnecting operators.

[15] ANACOM justifies the asymmetrical application of this obligation by reference to MEO's unique position both at wholesale and retail level, having regard in particular to its high market share, the ubiquity of its network and the significant proportion of traffic terminated by MEO. In ANACOM's view, the RIO facilitates the negotiation of interconnection agreements with MEO (which is the only operator with a hierarchical network structure), thereby reducing barriers to entry, and will also contribute to streamline the migration to MEO's IP network through the publication of clear technical conditions for IP interconnection.

[16] This obligation will not apply in the first six months following the entry into force of ANACOM's final measure. ANACOM further clarifies in the reply to the Commission's request for information that the SMP operators will be required to apply the price caps only in those situations in which it will be possible to determine the termination rates charged by the relevant non-EEA operators.

[17] The 2019 and 2020 price caps are expected to enter into force on 1 October 2019 and 1 October 2020, respectively, following ANACOM's publication of the new prices on its webpage within the first quarter of the given year.

[18] ANACOM's WACC calculations for 2017 were not notified to the Commission. In the reply to the Commission's request for information, ANACOM explains that the exercise was a mere data update and did not imply any change in the methodology and assumptions used to calculate the WACC.

Parameters and values used by ANACOM to calculate MEO's WACC for 2017

Nominal risk-free rate	2.80%
Equity risk premium	6.98%
Equity beta	0.856
Nominal cost of equity (post-tax)	8.77%
Nominal cost of equity (pre-tax)	12.45%
Nominal cost of debt	4.38%
Debt premium over risk free rate	1.58%
Gearing (D/D+E)	41.89%
Marginal tax rate	29.50%
Nominal WACC (pre-tax)	9.0651%
Inflation rate (Euromonitor, 2017)	1.40%
Real pre-tax WACC	**7.56%**

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 with a 10-year maturity), the equity risk premium (ERP)[19] and the tax rate (the Portuguese marginal tax rate). In contrast, it adopts a 'notional' approach for the calculation of the three other WACC parameters – beta, gearing and cost of debt– 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 (5 years), gearing (5 years) and cost of debt (2 years).

Finally, for the calculation of the beta and the gearing, ANACOM relies on data from a peer group of sixteen telecoms operators[20].

3. COMMENTS

The Commission has examined the notification and the additional information provided by ANACOM and has the following comments:[21]

Need to notify all WACC updates

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

[19] ANACOM's ERP value for Portugal was calculated on the basis of three studies by: i) Pablo Fernandez, ii) Aswath Damodaran and iii) Dimson, Marsh & Staunton, as reported in the *Investment Returns Yearbook 2017* published by Credit Suisse.

[20] The peer group includes: BT Group; Deutsche Telekom; Elisa OYJ; Hellenic Telecommunications; KPN NV; Magyar Telekom; NOS GPS; Orange; Proximus; Swisscom; TDC; Telecom Italia; Telefónica; Telekom Austria; Telenor ASA; and TeliaSonera AB. ANACOM explains that these economic operators were selected in accordance with the following criteria: (a) operation in countries with similar levels of income; (b) supply of similar products and services; (c) market position similar to MEO's; (d) similar stage in lifecycle; and (e) size similar to MEO's.

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

the Access Directive, to impose a cost control obligation that meets the objectives of encouraging efficient investments, including in next generation 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).

The Commission takes note that the WACC calculated in 2017, which is used in the updated FTR cost model under assessment, was not notified to the Commission.

ANACOM observes in the reply to the Commission's request for information that not all previous WACC updates were notified by ANACOM to the Commission. Indeed, the last notification on this subject concerned the changes to the WACC methodology used by ANACOM (case PT/2016/1900[22]). ANACOM considers that, unlike the latter notification, the 2017 WACC calculation did not introduce any change to the methodology notified in 2016 but merely consisted in a data update.

The Commission recognises the different nature of the methodological changes notified by ANACOM in the past and the pure data update at issue here. However, the Commission considers that any new calculation of the WACC should be subject to the consultation procedures referred to in Articles 6 and 7 of the Framework Directive, regardless of whether the new WACC value results from a methodological change or simply an update of the data used in the calculation. The Commission therefore calls on ANACOM to consult interested parties and the Commission before adopting any measure related to the WACC in the future either as a stand-alone decision or as part of a market analysis or decision on remedies.

Considerations regarding the determination of the WACC

In line with its comments in case PT/2018/2076[23] concerning the wholesale mobile termination market, the Commission puts forward suggestions which may improve consistency in the calculation of the parameters of the WACC used in the updated FTR cost model.

Country-specific vs notional approaches

The Commission 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 and cost of debt). In the Commission's view, in order to properly account for the inherent risk of Portuguese fixed operators, 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 premium and gearing of the peer group may fail to capture intrinsic elements of the SMP operators' systematic risk (such as specific national demand and/or supply conditions). At the same time, relying solely on the SMP operators' data to estimate these parameters may encompass their potential inefficiencies. For these reasons - if the relevant information is publicly available - it might be more appropriate to use data specific to the Portuguese SMP operators to

[22] C(2016) 5783.

[23] C(2018) 3740.

accurately reflect the underlying risk of their operations, and only then compare these values to those of a peer group of telecoms operators.

On the other hand, given that the above approach would account for the SMP operators' inherent risk, 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 intuition 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 6.98% proposed by ANACOM. Indeed, a 2017 report by BEREC[24] calculates an average ERP of 5.77% for a selection of 31 EU and neighbouring countries.

Consistency of the averaging period

The Commission notes that ANACOM uses different averaging periods for the calculation of the RFR, beta, gearing and cost of debt. The Commission believes that 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.

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); and

---

[24] 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

- have their main operations in EU member states.

  As recognised by ANACOM in the reply to the Commission's request for information, the majority of the operators included in the peer group used by ANACOM to estimate the beta and the gearing are part of economic groups that do not only have fixed operations but are also present in other sectors and/or in various international markets. While the fixed/mobile convergence trend amid European operators may make it difficult to select a peer group of "pure play" fixed operators, the Commission believes that it is still possible to determine a "fixed" and "mobile" beta for a convergent operator, for example by using beta disaggregation techniques.

  Against this background, the Commission invites ANACOM to revisit the composition of its peer group according to the above mentioned criteria and, if deemed appropriate, adjust its composition. Additionally, the Commission suggests determining the "fixed" beta of the Portuguese fixed 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[25] 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[26] 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[27]. You should give reasons for any such request.

Yours sincerely,

For the Commission,
Roberto Viola
Director-General

---

[25] 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.

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

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