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Ryšių reguliavimo tarnyba (RRT)

Algirdo g. 27
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Lithuania

For the attention of:
Mr Tomas Barakauskas
Director

Fax: +370 5 216 156 4

Dear Mr Barakauskas,

Subject: Commission Decision concerning Case LT/2012/1369: Wholesale broadband access in Lithuania

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

I. PROCEDURE

On 4 October 2012, the Commission registered a notification from the Lithuanian national regulatory authority, Ryšių reguliavimo tarnyba (RRT)¹, concerning the wholesale broadband access market² in Lithuania.

The national consultation³ ran from 4 July 2012 to 4 September 2012.

On 16 October 2012, a request for information (RFI)⁴ was sent to RRT and a response

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 5 in 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 (Recommendation on Relevant Markets), OJ L 344, 28.12.2007, p. 65.

³ In accordance with Article 6 of the Framework Directive.

was received on 19 October 2012.

Pursuant to Article 7(3) of the Framework Directive, national regulatory authorities (NRAs), the Body of European Regulators for Electronic Communications (BEREC) and the Commission may make comments on notified draft measures to the NRA concerned.

II. DESCRIPTION OF THE DRAFT MEASURE

II.1. Background

The market for wholesale broadband access in Lithuania was previously notified to and assessed by the Commission under case LT/2005/267. RRT defined the relevant market as wholesale broadband access provided over the PSTN network at the following network levels including transmission: (i) from the end user to the DSLAM and (ii) from the end user to the backbone network (whether at ATM or IP level). RRT concluded that the geographical market was national in scope. Furthermore, RRT designated the incumbent operator Lietuvos Telekomas AB with significant market power (SMP), and imposed the following set of obligations: to provide access on reasonable request, price control and cost accounting, accounting separation, non-discrimination, and transparency. The Commission had no comments.

II.2. Market definition

RRT defines the wholesale broadband access service as the provision of non-physical or virtual network access, including bitstream access to the digital data traffic at a fixed location, in order to provide retail services. WBA is a wholesale product including (i) the transfer of a digital data flow in both directions using the access network, (ii) the transfer of a digital data flow in both directions using the core network, and (iii) associated facilities required for the transmission of a digital data flow in both directions using the access and core networks.

RRT includes in the market definition WBA services provided through metallic twisted-pair loops using DSL technology and FTTx and LAN lines using Ethernet technology⁵. WBA services provided over cable networks using the Docsis technology and WBA services provided by means of WiFi and WiMax technology were excluded from the market.

The relevant geographic market was found to be national.

II.3. Finding of significant market power

RRT designates TEO LT, AB (TEO LT) as holding SMP. Being the sole provider of WBA in Lithuania, TEO LT was providing its service to 10 alternative operators at the end of the analysis period⁶. In terms of market shares, TEO LT holds 58.3% of the relevant market (self-supply included).

RRT points out that TEO LT's offer includes only bitstream provided over copper lines, and not over its FTTH and FTTB/LAN infrastructures. In its reply to the RFI, RRT

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

⁵ In the first half of 2011, WBA provided via copper served 37.1% of all subscribers, FTTH based WBA 19.1%, and FTTB/LAN based WBA 43.8% of all subscribers.

⁶ In the reply to the RFI, RRT provided more recent data according to which TEO LT was providing bitstream to 7 operators at the end of the first half of 2012.

confirmed that a number⁷ of other providers of FTTx-based retail services (including cable operators) had deployed their own access networks. Taking into account only the FTTx segment, RRT reports that TEO LT's market share was 36.5% at the end of the analysis period. However, the next three biggest operators in terms of market shares served only 9.6%, 8.2% and 7.8% of end users receiving services via FTTx.

In addition to this, RRT highlights that the barriers to market entry are high, notes that there is no existing or potential countervailing buyer power, and concludes that TEO LT has no actual or potential competitors. Therefore, RRT states that, in the absence of regulation, TEO LT has an incentive to (i) deny WBA access and limit the provision of information to other operators, (ii) apply different prices and conditions to alternative operators and to its retail arm, which could lead to a margin squeeze, and (iii) charge excessive prices or apply predatory pricing for WBA services.

II.4. Regulatory remedies

Having in mind the above identified competition problems, RRT intends to impose the following regulatory obligations on the SMP operator:

- a. Obligation to grant access, through an access point situated either in the access network (DSLAM) or in the core network when WBA is provided at the IP level, in case of both copper and FTTx/LAN lines;
- b. A non-discrimination obligation⁸;
- c. Transparency obligation, including an obligation to announce a new WBA product minimum 6 months before the retail offer based on this wholesale input becomes available; and
- d. Obligation of price control and cost accounting.

Regarding the latter, RRT concluded that the Fully Distributed Costs (FDC)⁹ methodology is the most appropriate method to calculate cost oriented prices for WBA services provided over copper lines. Furthermore, taking into account the need to ensure regulatory integrity of the WBA market, RRT proposes to apply the same methodology to determine prices for WBA provided over FTTx/LAN technology.

In its analysis, RRT assessed a number of price control methodologies, especially focusing on FDC and the long run average incremental cost (LRAIC) methodology. FDC was chosen as the most appropriate method for the following reasons:

- FDC is based on actual costs incurred by the operator, ensuring a reasonable return on investment and therefore not reducing operator's incentives to invest.
- The FDC method can be implemented rather quickly, which is especially important given that prices for WBA services provided over FTTx/LAN are currently not regulated.

⁷ RRT reports that there were 52 retail service providers using FTTx technology (including TEO LT) at the end of the analysis period.

⁸ In its reply to the RFI, RRT explains that the non-discrimination obligation would imply specifying the conditions, including period of time, for publishing the reference offer to provide access, the requirements for the content of the offer, the procedure and conditions for the provision of access and associated services and information which must be made publicly available. Moreover, the non-discrimination obligation requires that the SMP operator determines, provides to RRT and publishes on its webpage the quality parameters of the delivery and provision of the relevant services.

⁹ RRT also refers to "The Rules for cost accounting according to the Fully Distributed Costs Method" of 28 December 2005.

- TEO LT is already obliged to use FDC to calculate prices for vertically related unbundled access (market 4), therefore RRT's proposal ensures a consistent regulatory approach.
- Although RRT recognizes that one of the main advantages of LRAIC is that it promotes efficiency, whereas FDC is often criticized as inappropriate in cases of inefficient investments, it notes that at the moment it does not dispose of sufficiently detailed cost accounting data to be able to determine whether fibre investments in Lithuania were carried out efficiently or not. However, RRT also points out that this data will be taken into account during the next market analysis.
- Finally, regarding the asset valuation method, RRT notes that FDC is most often used with historical cost accounting (HCA), whereas LRAIC with current cost accounting (CCA). The latter combination is often endorsed in relation to fibre roll out. However, in this particular case, RRT explains that the application of the CCA methodology would require significant human and financial resources, which would outweigh the potential benefits. In RRT's view, the application of one or the other method would not result in a significantly different outcome in the short or medium term as investments into fibre networks are well under way in Lithuania. Therefore, RRT finds it more appropriate to use the HCA methodology, at least until the next market analysis takes place.

Regarding the imposition of cost oriented prices, the mechanism somewhat varies depending on whether WBA is provided over copper or FTTx/LAN lines. In relation to prices for WBA provided over copper lines, RRT explained in its answer to the RFI that it will set a temporary price cap until it verifies the costs calculated by TEO LT. During this period, the SMP operator will not be allowed to charge prices higher than the ones it applied on 1 March 2012.

Furthermore, prices calculated according to the FDC methodology for the WBA service provided via FTTx/LAN will be published in TEO LT's reference offer within 2 months after the proposed obligations come into force. Together with the reference offer, TEO LT will provide RRT with its cost justification, which will enable RRT to verify whether the prices were calculated according to the chosen methodology. In case prices are higher than the costs, RRT will require TEO LT to change the reference offer, or it may impose price caps¹⁰.

III. COMMENTS

The Commission has examined the notification and the additional information provided by RRT and has the following comments:¹¹

Need to impose an effective price control mechanism

The Commission acknowledges that RRT's cost-orientation obligation obliges the SMP operator to calculate prices on the basis of the chosen costing methodology (FDC), in line with cost accounting rules in place.

The Commission notes, however, that in relation to prices for services provided over FTTx/LAN infrastructures, RRT's proposal cannot be regarded as a strict *ex ante* price control obligation since the SMP operator will apply the prices before

¹⁰ RRT may also oblige TEO LT to return the excess profits to alternative operators that used its service.

¹¹ In accordance with Article 7(3) of the Framework Directive.

RRT has a chance to verify them, allowing RRT to intervene only *ex post*.

The Commission points out that, in order to ensure regulatory certainty for access seekers and promote efficient investment by all operators, cost-oriented access prices should in principle be regulated on an *ex ante* basis. In accordance with the regulatory framework, such prices can be appropriately adjusted for investment risk, in order to drive both competition and investment in (next generation) infrastructure. Therefore, the Commission invites RRT to reconsider imposing an *ex ante* price control obligation also for services provided over FTTx/LAN infrastructure in its final measure.

Notwithstanding the above, the Commission also points out that a strict *ex ante* price control obligation on fibre infrastructure would not be necessary if there were sufficient competition safeguards in place. In the latter case, RRT should at least implement the following:

- (a) Equivalence of input, which generally requires SMP operators' own downstream operations to use the same products, processes, and prices as those used by their retail rivals. As equivalence of input can only be fully implemented over a longer time period, this requirement could consist in immediate terms in a firm obligation on and commitment by the SMP operators to undertake certain key initiatives over a set time period;
- (b) A transparency obligation regarding fibre, comprising a number of clearly specified KPIs and an effective enforcement and monitoring mechanism (such as internal or external regular audits) and publication of the KPIs;
- (c) A replicability requirement also for fibre based retail products;
- (d) An accounting separation obligation covering also fibre products.

In any case, RRT should additionally impose a cost-oriented access obligation on fibre in market 4, unless it provides evidence of a significant competitive constraint at retail level, attributable to (i) the absence of high and non-transitory structural barriers to entry and expansion, signified by the presence of well-developed alternative infrastructures with comparable reach and/or (ii) cost-oriented and non-discriminatory access to copper wholesale products.

The Commission is currently working on a recommendation that will provide guidance on the application of a non-discrimination obligation. The Commission invites RRT to review its analysis in the light of any subsequent recommendation adopted by the Commission, following its publication.

Forthcoming guidance on costing methodologies

The Commission notes that, in order to ensure regulatory integrity of the WBA market, RRT concluded that the Fully Distributed Costs (FDC) methodology based on historical costs is the most appropriate method to calculate cost oriented prices for WBA services provided over copper, as well as FTTx/LAN lines.

Given the importance of regulating key wholesale access products in the transition period to NGA networks in an effective and consistent manner across the EU, the Commission is currently working on a recommendation which will provide guidance on costing methodologies for key access prices. In the light of this, the Commission invites RRT to review its analysis upon publication of the relevant recommendation.

Pursuant to Article 7(7) of the Framework Directive, RRT 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/EC¹² 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 Commission¹³ 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.¹⁴ You should give reasons for any such request.

Yours sincerely,
For the Commission,
Robert Madelin
Director-General

¹² 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.

¹³ Your request should be sent either by email: CNECT-ARTICLE7@ec.europa.eu or by fax: +32 2 298 87 82.

¹⁴ The Commission may inform the public of the result of its assessment before the end of this three-day period.