Dear Mr Marín Quemada,

Subject: Commission Decision concerning Case ES/2017/2047: methodology of the Economic Replicability Test (ERT) for Telefónica's fixed wholesale products aimed at providing retail services to residential customers in Spain

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

1. PROCEDURE

On 29 December 2017, the Commission registered a notification from the Spanish national regulatory authority, Comisión Nacional de los Mercados y de la Competencia (CNMC)\(^1\), concerning the methodology of the Economic Replicability Test (ERT) to be applied to Telefónica's wholesale local\(^2\) and central access\(^3\) products (aimed at providing retail services to residential customers) provided at a fixed location in Spain.

The national consultation\(^4\) ran from 28 April to 8 June 2017.

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\(^3\) Corresponding to market 3b in the Recommendation on Relevant Markets.

\(^4\) In accordance with Article 6 of the Framework Directive.
On 10 January 2018, a request for information\(^5\) was sent to CNMC and a response was received on 16 January 2018.

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.

2. DESCRIPTION OF THE DRAFT MEASURE

2.1. Background

2.1.1. Wholesale local access provided at a fixed location (Market 3a)

The last full review of the market for wholesale local access provided at a fixed location in Spain was notified to and assessed by the Commission under case ES/2015/1818\(^6\). CNMC included copper and fibre access networks as part of the relevant (national) product market. Access provided over Cable TV networks continued to be outside of the market since it did not exercise a strong direct or indirect constraint on the traditional copper and fibre access network at wholesale level, according to CNMC.

Telefónica was designated as the operator with significant market power (SMP) and CNMC maintained the obligations already in place, i.e., (i) access\(^7\), (ii) cost-orientation\(^8\) and cost accounting, (iii) accounting separation, (iv) non-discrimination and (v) transparency.

CNMC imposed a virtual access obligation to Telefónica's fibre network (so-called 'NEBA local')\(^9\) in the whole territory of Spain, with the exception of the 66 so-called ultra-fast broadband (UFB) municipalities\(^10\). NEBA local would be developed on

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


7 In particular, CNMC kept the obligations imposed on Telefónica at national level regarding access to copper local loop unbundling (LLU) and to passive infrastructure. The obligation includes a procedure to follow when decommissioning a main distribution frame (MDF).

8 The rates for accessing Telefónica's copper-based wholesale services are cost-oriented and also need to pass an economic replicability test (ERT).

9 NEBA local has a local point of handover (PoH) and is developed on the basis of the existing fibre-based NEBA service which is imposed in market 3b.

10 In order to assess the overall level of competition on broadband markets, CNMC assessed two criteria: (a) the level of competition at retail level, and (b) prospective next generation access (NGA) development. With regards to the retail competition criterion, an MDF area is declared competitive (located in 'zone 1') in case the following two criteria are fulfilled (i) presence of at least 2 alternative operators operating either by means of own infrastructure or of LLU access, having a market share of at least 10% (ii) Telefónica's market share in the same area is below 50%. All other MDFs will be located in 'zone 2'. With regard to the prospective NGA deployment criterion, this is considered existent in a MDF area when (i) there are at least 3 NGA networks (FTTH or HFC) deployed and (ii) each of the NGA networks has coverage of at least 20%. When a MDF fulfils all the above criteria (retail competition plus NGA deployment) it is considered as an Ultra-Fast Broadband MDF and the municipalities containing at least one of those UFB MDFs are considered UFB municipalities.
the basis of the existing fibre-based NEBA service\textsuperscript{11} and would not be price-capped but subject to an ERT\textsuperscript{12}.

The Commission asked CNMC to closely monitor the market and to ensure that the approach based on UFB MDFs accurately reflected the level of competition of the corresponding UFB municipality over time.

In case ES/2016/1951\textsuperscript{13}, CNMC notified the details of the NEBA local reference offer submitted by Telefónica.\textsuperscript{14} NEBA local was to be offered with a limited number of profiles, starting initially with a profile containing the highest bandwidth (300 Mb/s)\textsuperscript{15}, at conditions set in the reference offer and at prices that are compatible with the ERT. The Commission did not comment on the proposed measure.

2.1.2. Wholesale central access provided at a fixed location for mass-market products in zone 1 and zone 2 (Market 3b)

The last full review of the market for wholesale central access provided at a fixed location for mass-market products in Spain was notified to and assessed by the Commission under case ES/2015/1819\textsuperscript{16}. CNMC included wholesale services based on copper, fibre, cable and LLU inputs in the market. CNMC identified two sub-national markets (‘zone 1’ and ‘zone 2’) on the basis of the criteria used to assess the competition at retail level\textsuperscript{17}. The market included only access to bitstream services for residential customers, while access to bitstream services for non-residential customers was excluded.

In Market 3b (zone 1) there was strong infrastructure-based competition due to the efficient use of wholesale products available on market 3a. CNMC did not find any operator with SMP and therefore proposed to deregulate the market. In market 3b (zone 2) there had not been a significant deployment of alternative infrastructures. Telefónica was designated as SMP operator in this sub-market and CNMC proposed to maintain the obligations already in place: i.e. (i) access, (ii) cost-orientation\textsuperscript{18} and

\textsuperscript{11} The NEBA service is a bitstream-type product imposed in the former wholesale broadband access market.

\textsuperscript{12} CNMC would notify the precise parameters of the ERT to the Commission in a separate measure (i.e. the one which is the object of the present decision).

\textsuperscript{13} C(2016)8877

\textsuperscript{14} According to CNMC’s notification of 2015, NEBA local should have been available within 18 months after the market review decision, i.e. around mid-2017.

\textsuperscript{15} NEBA local will initially be based on a single profile offering three symmetric classes of traffic, ‘best effort’, ‘gold’, and ‘real time’ and the corresponding symmetric capacities (300 Mb/s, 50 Mb/s, and 2 Mb/s, respectively). The maximum bandwidth is based on Telefónica’s offers currently on the market.

\textsuperscript{16} C(2015) 9722.

\textsuperscript{17} See footnote 10.

\textsuperscript{18} As regards fibre, Equivalence of Inputs together with an economic and technical replicability test replaced the previous cost-oriented approach. As for copper, access prices remain cost-oriented and also need to pass an ERT.
cost accounting, (iii) accounting separation, (iv) non-discrimination and (v) transparency.

CNMC maintained, for each of the MDFs belonging to zone 2, the obligation to provide access to the copper-based NEBA service. As to fibre, CNMC maintained the obligation of providing access to the fibre-based NEBA service, with the exception of MDFs situated within the UFB municipalities. The previous speed cap of 30 Mbps was removed.

In case ES/2016/1952\(^{19}\), CNMC revised the prices for the capacity-based element\(^{20}\) of the NEBA product for the regulatory period up to 2019. This capacity-based element is common to both copper- and fibre-based access products and therefore remains subject to cost-orientated prices (based on a BU-LRIC+ cost model). The Commission did not comment on the proposed measure.

2.2. Regulatory remedies

The current draft measure sets the key parameters of the ERT that CNMC will apply to Telefónica's most important residential\(^{21}\), ultra-fast broadband retail products. The goal is to supervise the prices that Telefónica plans to charge alternative operators for the provision of regulated wholesale access services to its FTTH network. These wholesale access services (and the related price control obligation based on the ERT) were introduced as remedies by CNMC in the latest review of the markets 3a and 3b, as described above.

Although the focus of the ERT is the NEBA local wholesale service (VULA-type product), the test will also play an important role in determining the price for the NEBA fibre service (fibre bitstream product).\(^{22}\)

The price that results from the ERT will set an upper limit to the monthly access fee Telefónica can charge for its wholesale access products, while giving it freedom to specify the exact price structure of additional components such as one-off fees for migration between services, cancellation, etc.

CNMC's new ERT introduces several simplifying features and modifications to the 2007 ERT, which is currently in use. It is defined with the following characteristics,

\(^{19}\) C(2016)8877

\(^{20}\) NEBA connections are charged on the basis of a fixed monthly fee per access, plus a monthly fee per capacity at the PoH, plus one-off fees (activation, cancellation, etc.) and prices for physical links at the PoH.

\(^{21}\) In the response to the request for information, CNMC informed the Commission that it expects to notify the details of the ERT for retail services aimed at non-residential customers during the first quarter of 2018.

\(^{22}\) CNMC intends to maintain a coherent relationship between the prices of the two types of fibre-based wholesale services, given that they share a significant portion of Telefónica's underlying infrastructure. The NEBA fibre service can be divided into two separate components, each with its own price: first, network access, which spans the connection between the end user and the MPoP and, second, capacity, which includes all transmissions between the MPoP and Indirect Access Point. Whereas the NEBA fibre capacity price will continue to be set on a cost-oriented basis, the network access price for NEBA fibre cannot be higher than the NEBA local maximum monthly fee, which is determined in compliance with the ERT.
which are broadly consistent with the provisions of the Commission’s 2013 Recommendation on non-discrimination and costing methodologies:

i. In contrast with the current methodology, the ERT will not be applied to Telefónica’s entire retail product catalogue, but only to six fibre-based flagship products identified by CNMC. The regulator may modify the list of flagship products every six months, according to pre-defined criteria.

ii. The ERT will apply a dynamic approach to determine the replicability of each of the identified flagship products. The assessment is based on a net present value framework that takes into account the revenues and costs that the hypothetical operator generates for a given flagship product over the ‘average customer lifetime’ (5 years).

iii. The operator’s revenues and costs are modelled following an Equally Efficient Operator (EEO) standard, which means that the theoretical operator’s economies of scale and overall cost structure will be considered to be comparable to those of Telefónica. Costs will be modelled using a BU-LRIC standard.

iv. The average promotions offered to its retail customers by Telefónica over the previous 12 months, on each of the identified flagship products, will be taken into account in the ERT.

v. The volume discounts that Telefónica might include in the reference offer for NEBA local and/or NEBA fibre (which are transparent and available to any third party) will be taken into consideration in the ERT. Additionally, CNMC makes explicit the possibility of opening a separate proceeding in order to assess whether the prices agreed between Telefónica and access-seekers in commercial deals (i.e. that are not concluded according to the conditions of Telefónica’s mandated reference offer) comply with the non-discrimination obligation in place.

The monthly access fee set by Telefónica in compliance with the ERT will be revised every six months using information submitted by the operator.

In case the revised monthly access fees for its existing flagship products, resulting from the application of the ERT on the basis of actual data, were to be lower than

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23 Commission recommendation on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment - C(2013) 5761.

24 The flagship products are (i) Telefónica’s retail bundles with the highest number of subscriptions by end-customers (that achieve the cumulated threshold of 80% of Telefónica's broadband client base), or (ii) products which migrate clients from a product included in the first criterion to another product with improved services, or (iii) other products that justify their inclusion in the list of flagship products because of their representative or exceptional nature.

25 The conditions agreed in commercial deals between Telefónica and access-seekers are likely to be tailor-made and complex in nature and, for this reason, CNMC proposes not to take them into consideration in the ERT but rather keep a separate monitoring process on them. In particular, Telefónica will be under the obligation of informing CNMC of (i) any wholesale commercial agreement reached between Telefónica and an access-seeker and (ii) the number of wholesale lines sold under commercial agreement on a monthly basis.
the fees set by Telefónica during the previous six-months (i.e. the product would have failed the ERT), the monthly access fee for NEBA local and NEBA fibre will be lowered automatically over the subsequent period in order to compensate access-seekers for having paid a wholesale price which was "too high" according to the ERT. As for new retail bundles of services by Telefónica added to the list of flagship products, these will need to pass the ERT before they can be launched on the market.

The NEBA local product is operative as of 19 January 2018. Given that by that date the current proceeding related to the ERT was not concluded, the regulator imposes a provisional monthly access fee price for Telefónica's NEBA local products which is set at the level of the current monthly fee for NEBA fibre; i.e. 19.93 €/month.26

The draft measure notified by CNMC also reviews the ERT to be applied to the copper-based services provided by Telefónica, the prices of which remain cost-oriented. The current ERT methodology, established in 2007, will broadly remain the same, with some adjustments applied to ensure consistency with the ERT to be exerted on Telefónica's fibre-based services and to reflect the fact that the importance of copper-based services has decreased in favour of fibre-based products.27

3. COMMENTS

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

**Need to ensure effective non-discrimination in the context of commercial deals between Telefónica and access-seekers**

CNMC considers that the existence of regulated offers does not preclude the possibility for Telefónica to conclude voluntary commercial deals with access-seekers. This could involve the provision of access with wholesale products similar to NEBA local and/or NEBA fibre, at conditions that may differ from Telefónica's regulated reference offer. The Commission welcomes CNMC's flexible approach as regards voluntary commercial deals, as these offer the possibility to adapt wholesale services to the specific necessities of access-seekers, in complement to regulated offers. For example, they could involve the provision of the access services in different geographic regions, the provision of wholesale access over fibre and/or over copper, different number of lines, ad-hoc technical characteristics of the service, different pricing structure, etc.

The law requires Telefónica to systematically notify to CNMC any wholesale deal involving NEBA local or NEBA fibre products agreed commercially, but the regulator is not required to approve such deals.

Given the potentially complex nature of these deals and their confidential nature (only CNMC receives the details of these agreements), CNMC concludes that the

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26 From the reply to the Commission's request for information, it is not clear by when Telefónica will submit its proposal to CNMC concerning the prices it proposes to charge for its retail and wholesale services, which will allow CNMC to perform the ERT.

27 For example, the ERT for copper services will also adopt a flagship product approach.
prices that are agreed in voluntary deals signed by Telefónica for its NEBA services should not be accounted for in the ERT.

In the notified draft measures, CNMC states that it reserves the right to review these deals and intervene if it concludes that the conditions do not comply with the objectives of the ex-ante regulation on Telefónica's NEBA products, in particular concerning non-discrimination of access-seekers. If it emerged from the analysis that the deal is discriminatory towards other access-seekers, then CNMC would have the powers to intervene.

Against this background, while the Commission welcomes the possibility for Telefónica to enter into commercial deals with access seekers, it would like to reiterate the need to monitor such deals to ensure they do not impose conditions that may negatively affect competition. As regards their monitoring, the Commission notes that given their confidential nature, CNMC should not rely solely on third-party complaints to identify potential concerns with commercial deals. Instead, the Commission urges CNMC to closely review any commercial deal involving Telefónica's NEBA products, to ensure that the obligation of non-discrimination is effectively respected by the SMP operator. In particular, the Commission stresses the importance that all access-seekers have the possibility to benefit from the same non-discriminatory conditions (including volume discounts) in comparable deals with Telefónica. The CNMC should, in particular, ensure that commercial deals are not used strategically to the advantage of a specific access-seeker with the potential goal of foreclosing competition from other access-seekers.

**Duration of the provisional prices for NEBA local and NEBA fibre**

The Commission notes that Telefónica has not yet submitted to CNMC the prices it proposes to charge for its fibre-based flagship products and wholesale services which is required in order to perform the new ERT.

Due to this, the CNMC is proposing to put in place a provisional monthly access price for NEBA local – available on the market as of 19 January 2018 – which is set at the level of the current monthly fee for NEBA fibre; i.e. 19.93 €/month.

The Commission acknowledges CNMC's reasons for introducing a transitional price for the newly-launched NEBA local service. However, the Commission reiterates the need to switch as soon as possible to the newly established ERT, which is expected to result in more appropriate prices for NEBA local and NEBA fibre.

Against this background, the Commission invites CNMC to ensure that Telefónica submits its wholesale pricing proposal within a reasonable timeframe once the ERT model is finalised. This will ensure that, once the wholesale and retail inputs are updated in the model, the current prices based on an outdated model can be effectively replaced as soon as possible by prices which can be foreseen to be compliant with the new ERT regime.

Pursuant to Article 7(7) of the Framework Directive, CNMC 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\textsuperscript{28} 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\textsuperscript{29} 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.\textsuperscript{30} You should give reasons for any such request.

Yours sincerely,

For the Commission,
Roberto Viola
Director-General


\textsuperscript{29} Your request should be sent either by email: CNECT-ARTICLE7@ec.europa.eu or by fax: +32 2 298 87 82.

\textsuperscript{30} The Commission may inform the public of the result of its assessment before the end of this three-day period.