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Vår referanse:  
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Mottakers referanse:

Att: Eivind Skaar Briseid og Christina Tetlie

Dato/sted:  
Fornebu, 09.03.2015

Antall vedlegg:

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## RESPONSE TO PUBLIC CONSULTATION ON NKOM'S DRAFT MARGIN SQUEEZE PRINCIPLES AND MODEL

### 1. Introduction

#### 1.1 Introduction


With reference to the Norwegian Communications Authority's (**Nkom or the Authority**) public consultation 9 February 2015, Broadnet AS (**Broadnet**) hereby submit comments in regards to the principles for margin squeeze tests for access in Market 4 and 5. The deadline for commenting is 9 March 2015.

This letter contains information that is business sensitive to Broadnet AS. We request that Nkom exempts highlighted passages from public disclosure further to section 13 of the Public Administration act and section 13 of the Freedom of information act.


#### 1.2 About Broadnet

Broadnet is one of the leading providers of fiber-based data communications to businesses and operators in Norway. The consumer market is served by our subsidiary Homenet AS. This response is on behalf of both Broadnet and Homenet. Broadnet has a nationwide fiber network at 40 000 km, and deliver services to 42 000 business customers and 56 000 residential customers. On the access side the copper network is still of significant importance in addition to the build of new fiber. Broadnet has approx. 500 own DSLAMs with approx. 55.000 access lines. In addition we buy WS copper access services from Telenor.

Broadnet has a continuous expansion and development of our network. Access to Telenor's network is an important supplement to building own infrastructure on locations where Telenor already has established an access and a parallel access is not profitable/feasible. As a consequence of this, access to Telenor's access network on reasonable terms is required to enable us to be a competitive alternative in the broadband market.



Our main product is internet access to residential customers, data solutions to professional B2B customers delivered as IP/VPN with internet access included in the service and Ethernet and SDH services to other operators/carriers. A typical professional customer has several locations in Norway. Customers with multi locations require a secure network with high quality and capacity and this is produced with a combination of fiber and copper access.



Currently approx. 75 % of our broadband access lines are delivered over copper access. The migration to fiber access will accelerate. However the majority of broadband accesses over the next ten years will be based on copper.

Firstly we experience that price of building new fiber access is so high that it will take years to roll out fiber to all private and business customers in Norway.

Secondly the technological development of the utilization copper is expected to give us significant higher speed and new technological possibilities that will prolong the lifetime of copper. As we have seen historically from ADSL to ADSL2+, to VDSL and VDSL2 including vectoring and bonding there are new technological standards coming that will give new broadband opportunities on the copper access lines. In 2014 the G.fast technological standard was concluded (equipment already available) allowing up to gigabit speed on copper. In 2016 the VDSL 3 standard will be concluded also increasing end user speed.

## **2. Broadnet's comments and overall approach**

Broadnet support Nkom's initiative to develop an economic replicability test (ERT) for market 4 and 5. This test will be an important tool to ensure that alternative providers are able to replicate Telenor's offers at a retail level. Also, we agree with a number of principles described by the Nkom.

As described above the majority of broadband accesses will be produced over copper the next ten years. Broadnet's main concern is therefore that Nkom starts the process of testing margin squeeze in Market 4 and 5 at the wrong end. To ensure viable competition Nkom should test margins squeeze on copper and then move on to an ERT test on fiber. Alternatively a combined model must be built. The main reasons for this are;

- The majority of broadband access will be produced over copper the next ten years.

- New technologies will enable high speed broadband opportunities on copper increasing the importance of the copper in several geographical regions going forward.
- The copper market has available all relevant historical data related to volumes, market prices, Telenor cost and corresponding changes/development over time. Thus all data to conduct a viable margin squeeze test in an important market should be in place.
- The fiber based products that Telenor offers are not yet in widespread commercial use.
- An ERT model on fiber does therefore not have enough data input to develop a robust model.
- The work on the LRIC model in Market 4 and 5 has provided the Authority with sufficient data to perform a margin squeeze test based on fiber.
- This test could be developed after the margin test in Market 15 or taken into a combined model for copper and fiber.

The ERT test will not have any value for Telenor's wholesale customers unless Nkom commits to intervene rapidly if Telenor should fail the test. Broadnet therefore request Nkom to provide predictable guidance on how Nkom will monitor compliance and, if necessary, intervene.

An infringement of the imposed remedies in Market 4 and 5 will result in economic losses for the alternative network providers. Nkom should therefore also ensure that the access buyers are in a position to claim full compensation for the harm caused by the infringement.

### **3. Comments on selected principles for testing margin squeeze**

#### **3.1 Definition of margin squeeze (section 2)**

Broadnet agrees with Nkom's definition.

We support that the test must take cost of capital into account.

#### **3.2 Principle 1 – the level of efficiency (section 3.1)**

Nkom suggest applying an adjusted equally efficient operator (EEO) when as input to the lever of efficiency. Broadnet does not agree on the selected choice of level of efficiency of the reference operator. A margin squeeze test should be based on a reasonable efficient operator (REO) approach to ensure equivalence of output since Telenor is a dominant incumbent operator with a significant market share in the retail market for broadband services.

A REO based model will be the best way to adjust for scale which is one of the most important elements in an ERT test. By using REO the volume in the model will not be based on Telenor's volume and this will give a more effective approach for the alternative operators.

No other operator than Telenor is able to achieve such economies of scale and an application of EEO based model will preserve Telenor's position as the margin squeeze test thus will understate cost.

**3.3 Principle 2 – choice of business model (section 3.2)**

Broadnet agrees that each business model should be tested for each wholesale service separately. With regards to the retail services (3.2.2.), Nkom must also test an unbundled pure broadband (single play) offer in addition to double, and triple play offers.

If only double and triple play is tested there is a risk that the model allows Telenor to large flexibility to weighting different cost components in a way that allows cross-subsidization.

The suggested business model only reflects an operator that operates in the residential market and in the lower parts of the business market. Broadnet also operates in the mid- and high end of the business market. Neither SMB nor professional customers currently require or buy IPTV-services.

The suggested test will not identify margin squeeze in this market as revenues from TV will subsidize broadband services.

To address the business market (mid and higher part of the segment) we suggest that Nkom carry out a benchmark on defined contracts that Telenor have recently have won. The test must require Telenor's verity that alternative network owners such as Broadnet are able to replicate the retail price that Telenor offers to the defined business customers with profitability.

Broadnet agrees that the market should be national.

**3.4 Principle 3 – flagship products (section 3.3.1)**

The data input from us (in the request form) shows few flagship products. As described in section 3.3 above Broadnet do not offer IPTV services. We question the robustness of the model when it is based on so few flagship products.

In addition, it is not clearly defined when a product is designated as a flag ship product. Broadnet ask Nkom to specify the criteria for a product to be designated as a flagship product, and that this must be done as early as possible and at the latest before the product is launched on the market. If not there will be a lack of efficiency if Telenor can spend months on avoiding an ERT test just by not defining it as a flagship product.

**3.5 Principle 4 – retail price components (section 3.3.2)**

Broadnet agrees with Nkom's suggested approach.

We would like to underline the importance of calculating all relevant discounts, especially in the business market where a contract is negotiated and rebates one of the central elements in the process to win customers.

**3.6 Principle 5 – relevant methodology for running the test (section 3.4)**

Broadnet support Nkom's approach.

We would like to stress the importance of making the test able to detect temporary marketing of discounts initiated towards the end of one year lasting into the next year.

**3.7 Principle 6 – reference time (section 3.4)**

An ERT has to be carried out for a reasonable timeframe. We support the Discounted Cash Flow (DCF) approach however we would like to underline the importance of using estimated customer average lifetime other than Telenor. Telenor has traditionally a longer customer lifetime than alternative providers.

**3.8 Principle 7 – relevant cost standard (section 3.5)**

Broadnet agrees with Nkom's approach on using LRIC+ as the relevant cost standard.

**3.9 Principle 8 – reasonable profit (section 3.6)**

In order to be a competitive provider of broadband services it is necessary to produce "end to end" services of high quality. Thus it is necessary to own key parts of the network used to produce services. A model for testing margin squeeze must therefore ensure that alternative providers are able to achieve a reasonable margin and that they are attractive as an investment.

We find that the use of WACC is appropriate in this model.

**3.10 Principle 9 – relevant downstream costs (section 3.7)**

Broadnet recognize the listed cost elements as relevant.

**3.11 Principle 10 – relevant regulated wholesale inputs (section 3.8)**

Broadnet agrees that the test must take all elements of wholesale pricing into account. As referred to under section 2 we find it crucial to the effect of the ERT that the total cost of the complete value chain is reflected in the model.

One of the main problems in market 4 and 5 is that Telenor systematically design their wholesale products so that the alternative providers must purchase more elements than requested in order to get the customer access. A bundle of non-regulated cost elements gives the alternative network owners actual cost that prevents us from competing effectively with a margin in the end-user market. These are cost elements related to backbone capacity(e-line), housing, contractor work combined with different volume discount models. For service providers reselling Telenor WS services the same challenge occur. Telenor actual end-user pricing in their retail channels are down to the WS price for the service provider, leaving the service provider with a very small or no margin.

We would also like to point out that implementation of customers varies for private and business customers. Deliveries of broadband access to the residential market can be to a great extent be atomized.

Deliveries to the business segment are more complex and other cost elements like project management will incur.

### **3.12 Principle 11 – trigger for applying the test (section 3.3.1)**

Broadnet agrees that the test must be transparent and predictable for all market players, including alternative network operators

Telenor's planned launch of new services/offers at both the retail and wholesale level should trigger test (no launch before service/offer passes test).

Broadnet find that the test should be conducted at least every 6 months and agrees that the test should be conducted in other circumstances if appropriate, e.g. following complaint from access seeker

## **4. Final remarks**

Broadnet find that a test for margin squeeze cannot by itself (fully) ensure that discrimination does not take place. Further supervision of non-discrimination is essential and fast intervention is important if future analyses or complaints from access buyers indicate breach of the Market 4 and 5 decisions.

Broadnet asks for continuous access to file pursuant to section 18 of the Public Administration act during this process. Specifically we ask that Nkom forwards all documents received from Telenor in connection with this consultation.

To ensure that the work with a margin squeeze test address the competition problems that we are experiencing, we suggest arranging a meeting where we can elaborate on our comments and discuss how these issues can be dealt with. Please contact Per Morten Torvildsen, (+47 911 74 030) to set up a meeting.

Kind regards

Broadnet AS



Per Morten Torvildsen

CTO

% 1: Data request