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"Confidential version"

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RESPONSE TO PUBLIC CONSULTATION ON NKOM´S DRAFT MARGIN SQUEEZE PRINCIPLES IN MARKET 4 AND 5

1. Background

Reference is made to the Norwegian Communications Authority's ("Nkom" or the "Authority") public consultation 10 February 2015. The Authority has invited players to submit comments concerning WIK Consult's principles for margin squeeze tests for fiber access in Market 4 and 5 (the "Document"). The deadline for commenting is 9 March 2015. In the following TDC AS and Get AS ("TDC/Get") will submit its response relating to the aforementioned documentation.

This letter contains information that is business sensitive to TDC/Get. Consequently we ask that Nkom exempts highlighted passages from public disclosure pursuant to section 13 of the Public Administration act and section 13 of the Freedom of information act.

2. Summary

TDC/Get supports Nkom's initiative to develop a margin squeeze model. Also, we agree with a number of principles described by Nkom. However, in order for any model to be effective it must be able to identify an actual, not a hypothetical margin squeeze.

The suggested principles have several shortcomings that could distort the results. A single play "flagship product" that is the most relevant for the business market must be included as well as a benchmark test for the top end of the business segment. Without these supplements the test will not address the existing competition problems in the business market.

The margin squeeze test will not have any value for Telenor's wholesale customers if Nkom does not commit to intervene rapidly should Telenor fail the test. TDC/Get therefore asks Nkom to provide firm and predictable guidance on how Nkom will monitor compliance and, if necessary, intervene.

We would like to point out that Telenor has already given its own retail arm a substantial first mover advantage by delaying the introduction of relevant wholesale access products.

3. TDC/Get's comments on the overall approach

3.1 TDC/Get supports the introduction of a margin squeeze test (section 1)

TDC/Get supports the introduction of a margin squeeze test in Market 4 and 5. This is in line with the Commissions recommendation on consistent non-discrimination obligations and cost methodologies and the comments from the Efta Surveillance Authority ("ESA"). Such a test is required in order to ensure that alternative providers are in a position to replicate Telenor´s offers at the retail level.

We also agree with WIK´s overall approach.

However, some of the principles put forward will not ensure alternative network operators the equivalence of input required by the regulatory framework. TDC/Get asks that Nkom corrects these shortcomings before finalizing the model.

3.2 Scope and comments to data input

TDC/Get owns a national fiber based backbone network and we produce services to our customers including broadband access on this network. Our network covers large parts of Norway, but in some cases we have to supplement own infrastructure with access from Telenor and other providers where they have infrastructure at the customer site.

In order to produce cost effective and competitive broadband services it is important for us to utilize as much of our own infrastructure as possible and we therefore do not want to purchase other elements than the relevant access needed.

Telenor tends to offer access products that include more elements than we need; and by Telenor creating a mandatory bundle of products, our total cost becomes too high compared with the price that the end users are willing to pay for the service.

The purpose of the economic replicability test is to ensure that Telenor (that has a SMP status) does not abuse its dominant position to exclude competitors from the market. We find that this has been a problem over the past regulation periods and we are not convinced that this problem will be solved for the broadband market with the margin squeeze test as it is drafted.

We would like to point out that we often are charged with an establishment/investment fee (anleggsbidrag) when making a requirement for fiber access. Telenor's current practice gives us a high uncertainty of what the actual price for a fiber access will be. Exempt from public disclosure; [redacted]

From our experience, more than 50 % of all broadband access in the business market is delivered on copper access.
The scope of this margins squeeze test is only fiber access and TDC/Get calls for an inclusion of copper in the model in order to test the replicability for the broadband market in general.

When working on the data request that Nkom and WIK will use in the margin squeeze model we find that we have limited relevant data to provide;

- We have so far not ordered access based on Telenor VULA. The way this product is set up it is not suitable for our business.
- The Ethernet Connect product is not ready for delivery from Telenor.
- There is only one relevant product in our business segment to provide information on.

The input from the access buyers will not give all the necessary information to make a solid model on fiber. However, on copper all the alternative network owners have relevant information to share.

In Denmark the development of a margin squeeze test on copper has been developed since 2009. The first test was performed in 2013. Fiber will be included earliest in the end of 2015. We see that NRA chose to start with a copper test and then move on to testing fiber.

TDC/Get therefore requests that copper access should be included in the model that will test margin squeeze in market 4 and 5.

TDC/Get finds that a test for margin squeeze cannot by itself (fully) ensure that discrimination does not take place. Further supervision of non-discrimination is necessary. We will comment further on this at a later stage in the process.

3.3 Enforcement (section 1)

Nkom will have to effectively supervise and enforce the test in order to prevent discrimination.

We note that the Document does not discuss how the Authority intends to react if Telenor fails the margin squeeze test. On this basis we ask Nkom to provide firm guidance on how the Authority will use the model and how it will intervene if Telenor fails the margin squeeze test. The Authority should as a minimum:

- Set out that Telenor has to adjust wholesale prices no later than 14 calendar days after failing the test,
- State that the Authority will automatically order Telenor to adjust prices if these have not been adjusted within the period referred to above and
- State that the Authority will automatically impose a fine if Telenor fails the test. The fine must be sufficient to deter Telenor from exposing competitors to a margin squeeze.

3.4 Compliance actions (section 1)

An infringement of the imposed remedies in Market 4 and 5 on the part of Telenor will result in economic losses for the alternative network provider(s) concerned. Nkom should therefore ensure that the final decision on the margin squeeze test is drafted in such a way that aggrieved parties are in a position to claim full compensation for the harm caused to them the infringement.

3.5 Definition of margin squeeze (section 2)

TDC/Get agrees with WIK´s recommended definition and that the test must take cost of capital into account. This should be specified in the final decision as Nkom incorrectly excluded this factor from the Market 15 margin squeeze model.

4. TDC/Get's comments on the suggested principles for testing margin squeeze

4.1 Principle 1 – the level of efficiency (section 3.1)

TDC/Get agrees with WIK that a "pure" as efficient operator test in not suitable in Market 4 and 5. The test must reflect the relevant income and cost structure of a representative alternative operator, e.g. a competitor of Telenor in the retail market buying the wholesale services in question.

TDC/GET agrees that the input should be adjusted so that the "relevant downstream costs which correspond to an EEO" in line with WIK´s recommendation, cf. page 6:

> *"Further adjustments can be made if there is evidence that the pure EEO concept would not consider cost components which however occur to an efficient altnet which relies on the SMP operator's wholesale access service. Such costs may occur for example for co-location services. If it is believed that neglecting these cost components would prevent market entry or expansion, these cost parameters are taken into account."*

In addition, we recommend that Nkom performs a sanity check of the input provided by Telenor in line with the statements on page 6 of the Document:

> *"Relevant input parameters will be collected from the SMP operator. However, altnets can also be asked to provide these input parameters. This enables the assessment of whether the input parameters provided by Telenor are reasonable and reflect the cost of an efficient operator or if adjustments are necessary to ensure that an efficient altnet would also recover its costs."*

4.2 Principle 2 – choice of business model (section 3.2)

TDC/Get agrees that the market should be national.

WIK states that the test should reflect the operations of a representative alternative network operator in the retail market (page 6). TDC/Get fully agrees with this approach. If the Authority tests offerings that are not relevant for Telenor´s competitors, Nkom could incorrectly assume that wholesale customers are not in a margin squeeze even though they are not able to replicate "the non-tested offers". Also, such an approach would allow Telenor to rapidly put into place a new margin squeeze through aggressive marketing of products that are not covered by the test.

The market shares should also be calculated separately for providers operating in business and residential markets (current principle only based on "homes connected").

TDC operates in the business market. Neither SMB nor professional customers require or buy IPTV-services. TDC/Get would like to point out that the business model put forward by WIK (double and triple play including TV services) is not fully representative for the total market we are operating in.

The suggested business model only reflects an operator that operates in the residential market. In addition to the two double and triple play tests TDC/Get therefore find it of great importance that an unbundled pure fiber offer "single fiber" is included as a separate test in order to detect margin squeeze in the business market/segments.

In order to address the existing competition problems in the business marked we are convinced that Nkom also must include a benchmark test reflecting the higher part of the business segment. Based on our experience in Market 15 the best way to do this is to perform a benchmark test for recent and selected cases in this segment.

[redacted]

If these two extra tests are not included in the model, the consequence is that Nkom not will be able to detect discriminatory behavior in the form of margin squeeze.

4.3 Principle 3 – flagship products (section 3.3.1)

TDC/Get agrees with WIK´s suggested approach as long as the "flagship products" in question also reflect Telenor´s product offering in the business markets (e.g. not only double and triple play offers including TV).

However, WIK does not clearly define at which point in time a product is designated as a flag ship product. In order to ensure predictability for both the incumbent and the alternative providers a product should be designated as a flagship product as early as possible, and in any case no later than 3 months before commercial launch of the product in question.

4.4 Principle 4 – retail price components (section 3.3.2)

TDC/Get agrees with WIK´s suggested approach to retail price components.

We would like to stress the importance of taking all relevant discounts into account. Time-limited rebates are a key concern in the retail market as well as the SMB segment in the business market where subscriptions tend to be standardized.

Further, large business account customers rarely pay the listed prices. Permanent rebates are common. Telenor regularly offer large corporate accounts market various forms of rebates and remunerations.
This is the price level alternative network operators have to compete with in order to win the customer.

TDC/Get does not have detailed information on what types of discounts Telenor offer large corporate accounts as this information is business sensitive. Nkom is however in a position to request the necessary input from Telenor (for instance relating to the 10 largest customers) and update the model accordingly.

Nkom's accounting separation model has historically not been capable of identifying such practices. This is partly due to the fact that the Authority has decided to use average cost and revenue data for a 6 months period. This approach makes it possible for Telenor to effectively cut prices during the reporting period and recoup losses through higher prices at a later stage but still demonstrate profitability overall.

If Telenor for example in January launches an offer on speed X offering the customers the product for free in January and February, launches a (parallel) offer on speed Y in March and April, makes another offer on speed Z in May and June and so on, Telenor will be able to continually exclude the competitors in relation to attracting new customers.

This type of predation will however not be caught by the model if Telenor ensures that the total of the group of flagship products in question are profitable over a 6 month period. Thus Telenor will be able to use the fact that Telenor has a large (stable) base of customers with high revenue to subsidize its temporary discounts. An altnet with a smaller customer base would not be able to meet the competition from the incumbent on a level playing field.

4.5 Principle 5 – relevant time period and methodology for running the test (section 3.4)

TDC/Get agrees with WIK´s suggested approach to the relevant methodology for running the test.

With regard to the relevant time period we would like to point out that the average life time of Telenor´s customers is normally longer than what is the case for the customers of alternative network operators. Nkom should take this into account and adjust the input if required.

4.6 Principle 6 – reference time (section 3.4)

TDC/Get agrees with WIK´s suggested approach to the reference time.

4.7 Principle 7 – relevant cost standard (section 3.5)

Under the condition that Nkom's LRIC+ model is designed in accordance with the Commission and BEREC recommendations TDC/Get agrees that this should be the relevant standard for calculating retail costs.

4.8 Principle 8 – reasonable profit (section 3.6)

TDC/Get agrees with WIK that the model must ensure that an alternative network operator is in a position to earn a reasonable rate of profit. WACC reflects the risk of a retail business for Telenor´s competitors. WIK´s suggested approach is in line with inter alia the Commission recommendation and competition law principles.

4.9 Principle 9 – relevant downstream costs (section 3.7)

TDC/Get finds that the downstream cost includes the relevant cost elements. With regards to costs obtain from the existing LRIC model replicating Telenor cost, Nkom must assure that these costs are adjusted to take into account the lower market penetration and lower utilization of the network given the footprint of the network. If trench sharing between core and access network is assumed in the existing LRIC-model, this sharing should be eliminated in the altnet cost since this network will primarily consist of core transportation and is established without possibility of trench sharing with access network. Cost sharing obtained with mobile network assets should be eliminated as well.

When looking at cost from the SMP operators account, Nkom should be aware that an altnet is purchasing wholesale services from the SMP. Cost for a purchasing organization that handles renting and the ongoing communication with the SMP should therefore be included. Such cost is not a part of the retail cost that can be obtained from the SMP's account.

For the Retail cost, a cost of capital for e.g. IT-assets (billing systems etc.) should be included similar to cost of capital for network costs.

4.10 Principle 10 – relevant regulated wholesale inputs (section 3.8)

TDC/Get agrees with WIK that the test must take all elements of the wholesale pricing into account. Nkom can not only look at the regulated wholesale costs but must also look at the other elements that are a natural part of an access product. If this is not being done, Telenor will be able to bypass the regulation.

We find that relying on input based on list/standard prices from Telenor are not sufficient, since we have experienced that additional cost is adding up during the fiber projects. We find that *de facto* incurred cost for a sample of operator-projects should be investigated in order to establish a mark-up on the list prices and thereby capture the total fiber line cost.

4. 11 Principle 11 – trigger for applying the test

TDC/GET agrees with WIK that the following triggers for applying the test are relevant:

1. "The MST will be conducted each time a new wholesale price in Market 4 or 5 is determined and/or a new wholesale product is being introduced."

2. "A MST for each relevant wholesale service will be conducted periodically, every 6 months, in line with the existing 6 months collection of subscriber data for Nkom's statistics report."

3. "Additional MSTs may be conducted under reasonable and proportionate circumstances. This may in particular be the case if competitors make justified reasoning of major market changes related to costs, prices, and customer distribution which would lead to different results compared to the original ex ante MST."

Regular reviews of Telenor´s margins for a predetermined period of time will provide the Authority with valuable information of Telenor's compliance with regulatory obligations. With regard to No 1 TDC/GET is of the opinion that Nkom should also run the test if Telenor launches, retracts of alter the identified "flagship products" in the retail market. Material changes in prices should also trigger a review. Adoption of the test will give Telenor a strong incentive to aggressively market "non-flagship" offers that are not tested.

Further, the decision introducing the test should specify that Telenor may not launch or amend the product(s) in question before they have been tested. This will ensure a level playing field as the incumbent loses the "first mover advantage" Telenor benefits from today as both a wholesale provider and a competitor in the retail market.

Concerning No 2 TDC/Get strongly suggests that Nkom commits to performing the test every 3 months instead of every 6 months. Once the model is in place the administrative resources required to review the wholesale and retail prices should be negligible compared to the potential welfare loss of a margin squeeze.

5. Concluding remarks

TDC/Get asks for continuous access to file pursuant to section 18 of the Public Administration Act for the duration of this case. Specifically we ask that Nkom forwards all documents received from Telenor in connection with this consultation; including but not limited to, any response, models, presentations, e-mails or other form of documentation submitted to the Authority.

I you have any questions concerning these comments please contact me at oyvind.husby@get.no or (+47 93444140).

Best regards
TDC AS and Get AS

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