

**Decision on the results of audits of universal service net costs reported by
MEO – Serviços de Comunicações e Multimédia, S.A.,
for the 2014 financial period**

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1. Framework

During part of 2014, and as in previous years, MEO – Serviços de Comunicações e Multimédia, S.A. (MEO) provided the universal service (US) of: i) connection to a public communications network at a fixed location and provision of a publicly available telephone service through the said connection (FTS), ii) a comprehensive directory and of a comprehensive telephone directory enquiry service, and iii) public payphones (PPP) throughout the national territory, under the concession contract in force at the time.

It should be noted that contracts on US offers were signed in 2014 further to designation procedures, whereby the dates on which each of these offers started determined the dates of termination of US offers by MEO under the concession contract concluded between the State and the then PT Comunicações (currently MEO - Serviços de Comunicações e Multimédia, S.A.), on 20.03.1995, modified by an amending agreement concluded between the parties on 03.04.2003.

As such, on 19.02.2014, the Portuguese State and Optimus – Comunicações S.A. (OPTIMUS) signed a contract for the provision of the US of connection to a public communications network at a fixed location and of publicly available services in the North and Centre areas. On the same date, a contract was signed between the Portuguese State and ZON TV Cabo Portugal, S.A. (ZON) for the provision of the same service in the South area and Islands. These two companies, further to a merger through the incorporation of ZON into OPTIMUS, currently integrate a sole company under the name NOS Comunicações, S.A., which started the provision of the FTS US on 01.06.2014.

On 20.02.2014, PT Comunicações (currently MEO) and the Portuguese State signed contracts for the provision throughout the national territory of the US of a comprehensive directory and of a comprehensive telephone directory enquiry service, as well as of the public payphones US, having the company started the provision of these services on 20.02.2014 and 09.04.2014, respectively.

Pursuant to article 95 of the Electronic Communications Law (ECL)¹, where the National Regulatory Authority (NRA) considers that the US provision may represent an unfair burden on the respective providers, it must calculate the net costs of the universal service

¹ Law No. 5/2004, of 10 February, as it currently stands.

(CLSU - *custos líquidos do serviço universal*) in accordance with one of the following procedures:

- a) Calculating CLSU, taking into account any market benefits which accrue to providers;
- b) Making use of the CLSU identified by a designation mechanism in accordance with the provisions of ECL.

As such, in compliance with that article and in line with article 96 of the same law, Autoridade Nacional de Comunicações (ANACOM) approved in 2011 a decision on the concept of unfair burden, as well as a decision on the methodology to be used to calculate CLSU².

Above-mentioned decisions establish also the methodology to calculate CLSU, as from the moment it is deemed that its provision may represent an unfair burden (that is, as from 2007, inclusively) and for as long as the US is provided by MEO under the concession contract, which was the case for a part of 2014, as referred earlier.

Taking into account that the methodology for calculating CLSU was developed on an annual basis and bearing in mind that the dates on which services started to be provided, referred above, led MEO, in 2014, only to provide the US for a part of the year under the regulatory framework for the period preceding the tender designation of a universal service provider (USP), ANACOM approved on 22.07.2015 a decision that adapts the CLSU calculation methodology to this circumstance³.

The ECL provides that the USP has a duty to make available all accounts and other relevant information for the purpose of CLSU calculation, observing determinations issued by ANACOM. MEO accordingly submitted to this Authority, on 30.10.2015, CLSU estimates for 2014⁴.

² The following determinations are also relevant in this context: (i) determination of 25.11.2011 which approved the price-elasticity of demand effect in the element associated to retired persons and pensioners; (ii) determination of 12.10.2012 which implemented the concept of “abnormally high access costs”, to determine unprofitable customers in profitable areas; (iii) determination of 20.06.2013 which determined adjustments on the CLSU calculation methodology with impact on estimates for years after 2009; and (iv) determination of 20.11.2014 which determined the review of the adjustment made to avoid double-counting of traffic between unprofitable customers in profitable areas.

³ Decision on the methodology for calculating universal service net costs for 2014.

⁴ Reference to 2014 CLSU must be regarded, in the context of this document, as CLSU incurred by MEO in the period between 1 January 2014 and 31 May 2014 for the provision of FTS and between 1 January 2014 and 8 April 2014 for the provision of PPP service.

Being incumbent on ANACOM to submit estimates presented to audit, under paragraph 4 of article 96 of ECL, as well as to approve CLSU values, this Authority awarded, on 16.09.2015, to AXON Partners Group Consulting S.L. (hereinafter AXON) the audit to CLSU estimates presented by MEO for the 2014 financial year. The audit work started at the end of 2015.

The audit consisted of a thorough, systematic and comprehensive analysis of CLSU estimates presented by MEO for 2014, to check whether they met principles, criteria and conditions laid down in ANACOM's determinations, as well as to review calculations and sources of information, as well as the identification and analysis of any limitations, discrepancies, alternative approaches and all relevant matters related to the methodology used.

In the course of the audit, having been completed an initial checking of information submitted by the company, auditors conveyed to MEO recommendations intended to correct some situations which had been identified, having MEO submitted new CLSU estimates to auditors on 27.01.2016, in order to meet the referred situations. Subsequently, MEO, which in the meantime had recast values of the Cost Accounting System (CAS) available for 2014, submitted to auditors, on 06.05.2016, reviewed results of 2014 CLSU in the light of those values⁵, informing ANACOM of this fact. These results were audited by AXON in the scope of the same audit procedure, and auditors submitted a final report of the overall audit to 2014 CLSU on 19.07.2016, which covered conclusions on the first estimates presented by MEO in October 2015 and corrected by the company in January 2016 and final conclusions on estimates resubmitted by MEO in May 2016.

By determination of 10.08.2016, ANACOM approved a DD on the results of audits to MEO CLSU for 2014, which was submitted to the general consultation and prior hearing procedures for a period of 20 working days.

In the scope of the referred procedure, three contributions were received within the time limit set for the purpose, which were summarized and analysed in the public consultation and prior hearing report, which is an integral part of this decision. Positions presented did not determine any amendment of the draft decision submitted to public consultation and prior hearing of stakeholders.

⁵ It should be noted that recast CAS values for 2014 used by MEO when 2014 CLSU were resubmitted correspond to values approved by decision of ANACOM on 25 May 2016, further to an audit to MEO's 2014 CAS results.

2. Main findings of audits

In cooperation with Grant Thornton & Associados, SROC, Lda⁶, AXON conducted an audit to CLSU estimates presented by MEO for 2014, and prepared a preliminary audit report after concluding the fieldwork.

Findings of the audit work were discussed between MEO and auditors, and on 27.01.2016 MEO presented new calculations in order to implement recommendations made by auditors. Following the determination of recast CAS values for 2014, in view of the audit to which the CAS had been subject, MEO submitted on 06.05.2015 new CLSU estimates for 2014. These 2014 CLSU values resubmitted by MEO thus take into consideration recast and audited values of the 2014 CAS, and implement recommendations presented by auditors, except for those which concern the reconciliation with CAS.

Resubmitted values were audited by AXON, which sent its draft final audit report to ANACOM in early June. This report was conveyed to MEO, on 08.06.2016, for comments.

MEO sent its comments to the audit report on 07.07.2016, stressing that 2014 CLSU estimates show a high degree of reliability, a fact which it deems to be evidenced by the audit which only detected some inaccuracies and inconsistencies in calculations and models updates, the impact of which is referred to be minor compared to the total value of CLSU.

In the final audit report, AXON refers that “(...) *except for reconciliation limitations indicated above, which may result in underestimated CLSU, results and calculations resubmitted by MEO are in compliance with principles, criteria and conditions laid down in ANACOM determinations, and data, assumptions and calculations used are adequate enough.*”

Auditors identify throughout the referred report reconciliation problems between the CLSU model and sources of information (CAS), and detected some discrepancies in calculations or data used, situations which are described in detail in the audit report and analysed herein.

⁶ Hereinafter reference is made only to AXON, the company with which ANACOM contracted the audit service.

The table below presents CLSU results for the 2014 period during which MEO provided the US under the concession contract, including results initially presented on 30.10.2015 and values resubmitted by MEO on 06.05.2016, further to the implementation of recommendations made by auditors to initial results, as well as recast CAS results for 2014, which were again audited and which correspond to final values.

Table 1 – 2014 CLSU estimates* (initial values and final values)

	2014*	
	Initial values Data for 30.10.2015	Final values Data for 06.05.2016
Lost revenue of unprofitable areas	€ 538,577	€ 499,798
Lost revenue of unprofitable customers	€ 6,985,935	€ 7,083,328
Lost revenue of unprofitable public payphones	€ 812,121	€ 928,056
Total lost revenue	€ 8,336,633	€ 8,511,182
Avoidable costs of unprofitable areas	€ 759,811	€ 690,514
Avoidable costs of unprofitable customers	€ 11,687,064	€ 11,355,860
Avoidable costs of unprofitable public payphones	€ 1,279,824	€ 1,716,807
Revenue not obtained from pensioners	€ 2,796,308	€ 2,796,308
Total avoidable costs	€ 16,523,007	€ 16,559,489
Unprofitable areas	€ 221,234	€ 190,716
CLSU of unprofitable customers	€ 4,701,129	€ 4,272,532
CLSU of unprofitable public payphones	€ 467,703	€ 788,751
Discounts granted to retired persons and pensioners	€ 2,796,308	€ 2,796,308
Total CLSU before indirect benefits	€ 8,186,375	€ 8,048,307
Total indirect benefits	€ 321,030	€ 326,636
Total CLSU	€ 7,865,345	€ 7,721,671

Source: MEO.

* FTS between 1 January and 31 May 2014 and PPP between 1 January and 8 April 2014

It may be observed from the table above that resubmitted results entailed a reduction by €143,674 in the final value of CLSU compared to the value submitted initially by MEO.

The following chapters analyse in greater detail audit results and main findings, as well as ANACOM's views thereon. An analysis to 2014 CLSU values is also conducted.

3. Analysis of elements of CLSU estimates presented by MEO and of AXON's findings and recommendations

This section focuses on whether MEO complies with each aspect of the methodology for establishing CLSU. As such, a summary of the analysis and findings/recommendations of auditors is presented, followed by a reference to comments conveyed by MEO to the audit

report, and by ANACOM's views thereon. Furthermore, issues identified by AXON as regards any discrepancies in calculations and/or data inputs are also analysed.

The final part of this section deals with the reconciliation of CAS values with inputs of the CLSU calculation model.

3.1. General principles

The methodology approved by ANACOM determines that the establishment of CLSU is based on the determination of costs that the USP would avoid and revenues it would lose where, were it not subject to US obligations, it did not supply the service in unprofitable geographic areas, and in profitable areas, it did not supply the service to customers that were unprofitable therein, or did not supply the service in conditions which depart from normal commercial conditions. Information on costs required for this exercise is mostly obtained from MEO's accounting records, whereby USP costs and assets must be evaluated on the basis of historic costs.

As such, the calculation of CLSU results from the establishment of direct net costs, with a direct measurable impact on accounts of the USP, and of indirect benefits, from which the USP derives a gain as a result of being one.

The methodology further determines that CLSU result from the sum of loss-making components, that is, in case any of the components shows a positive margin, it should not be used to compensate negative margins calculated for other components. In fact, it is deemed that the USP would always provide non-deficit components of the service, even where it was not under the obligation to provide them.

The following US offers are thus taken into consideration: connection to the public telephone network at a fixed location and access to publicly available telephone services, including specific offers intended for retired persons and pensioners, and also the offer concerning the public payphone service.

It should be noted that positive margins of all services provided outside the scope of the US and which rely on US accesses are taken into consideration for the purpose of CLSU calculation. On this issue, ANACOM's determination of 20.06.2013, on audit results of CLSU for 2007-2009, specified that MEO must include as relevant services provided outside the US those that remain as profitable services as from 2007 up to the year to

which the CLSU estimate refers. Moreover, the company must present an annual analysis, and where appropriate, grounds, which will be appropriately weighted, for not considering services that may not be profitable on a multi-annual approach on a cumulative basis, but which on an annual approach present a positive margin for any of the years at stake.

The methodology determines also, with respect to the issue of how to treat one-off costs and revenues, that costs/ revenues of one-off installations must be annualised on the basis of the number of years to which corresponds the average useful life of MEO's customers, which was set at five years. As such, the methodology establishes that in each year, one-off costs and revenues assigned to customers installed in that year are annualised, as well as one-off costs and revenues of previous years assigned to customers installed in the years concerned.

In terms of geographical division, the methodology takes the USP network topology into account, whereby the area covered by each of MEO' Main Distribution Frames (MDF) is the reference unit for assessment of cost areas.

It is noted that, in 2014, MEO did not provide the US the entire year under the regulatory framework for the period preceding the USP tender designation. This led to the adjustment of the methodology for determination of CLSU for the period between 01.01.2014 and 31.05.2014 as regards the connection to the public telephone network at a fixed location and access to publicly available telephone services (FTS), and for the period between 01.01.2014 and 08.04.2014 as regards the provision of the public payphone (PPP) service.

In the scope of the decision of the CLSU calculation methodology for 2014 (decision of 22.07.2015), it was established that *"[a]s regards inputs (operational, financial and cost inputs) to be used in the calculation of CLSU, indicators which concern the period concerned, that is, inputs for the first 5 months of 2014, should be used as much as possible. In the scope of such inputs, in case average unit values calculated on the basis of annual CAS data for 2014 are used, the following issues must be safeguarded:*

- a) average unit costs determined for the period the US was provided must not be significantly different from average costs of the 2014 operation, namely as regards operational costs, costs of capital and amortizations; and*

- b) *Operational indicators (no. of installations, monthly payments, etc.) and financial indicators used to calculate costs must not be influenced by seasonal effects.*

In this context, MEO must fully demonstrate that average unit costs for 2014, as well as the operational and financial indicators used to calculate net costs, adequately reflect the company's operation in the referred period. It is stressed that in case significant differences are identified, MEO must identify and apply the necessary adjustments to remedy these differences."

Audit Report

Auditors describe in the audit report the process implemented by MEO to determine CLSU, which is based on the use of the following models:

- Avoidable costs model, which calculates inputs of avoidable costs feeding other CLSU determination models;
- Area model, which calculates CLSU of unprofitable areas;
- Customer model, which calculates CLSU of unprofitable customers;
- Public payphone model, which calculates CLSU of unprofitable public payphones;
- Model for retired persons and pensioners, which calculates CLSU arising from the offer granted to retired persons and pensioners;
- Indirect benefit model, which calculates indirect benefits which are deducted from overall CLSU concerning unprofitable areas, unprofitable customers in profitable areas, unprofitable public payphones in profitable areas and retired persons and pensioners.

As regards adjustments made to estimate CLSU for 2014, AXON refers that, at the level of revenues, these are identified for the 2014 January-May period on the basis of *"revenues entered in general accounts for the first five months of 2014, which are in line with those reported in the CAS, in compliance with ANACOM's determinations in the decision of 22.07.2015"*. AXON also refers that it found that *"those revenues take into account volumes recorded for each month, entered in MEO's operational systems, thus the criterion referred in preceding paragraphs relies on a basis of reliability, transparency and appropriateness, which reflect the business seasonal spread and evolution, which are very important so that the determination of CLSU accurately depicts the reality intended to be represented."*

As regards costs, the audit report describes the process of identification of relevant costs and mentions that it is based on annual costs of the CAS and traffic volumes corresponding to the first five months of 2014 reported in MEO's operational systems. On the basis of these inputs, MEO calculated unit costs taking into account the results of the analytical accounting model and volumes registered in the entire year. Subsequently, the proportion of volumes for the first 5 months of 2014 obtained from operational systems was multiplied by unit costs.

Moreover, the report stresses that MEO conducted reasonableness tests to evidence that costs of the period of service provision (January to May 2014) do not differ substantially from the use of average costs of the period. As such, on the basis of information supplied by MEO, auditors compared the share of monthly costs entered in general accounting and those included in calculations, having found that the accumulated difference in the 2014 January-May period amounts only 0.04%, having thus concluded that: *"(...) using average costs of the 2014 financial year is not significantly different from using average unit costs determined for the period of US provision (January-May 2014), thus calculations made and included in the model are in line with ANACOM's determinations"*.

It should be noted also, as regards the determination of avoidable costs and lost revenue arising from the provision of the public payphone services, that the calculation for the January-May 2014 period was conducted, and in compliance with ANACOM's determinations, MEO subsequently applied a correction factor based on the number of days on which the service was effectively provided, in order to estimate costs and revenues associated to this provision in the period between 1 January and 8 April 2014.

The determination of CLSU takes into consideration costs and revenues of all services included in the provision of the FTS and PPP US, as well as all services provided outside the scope of the US, but which rely on copper pairs and which present positive margins. As far as the latter are concerned, the audit report identifies categories of services excluded from the calculation of CLSU due to the fact that they present a negative accumulated margin between 2007 and 2014, and identifies a service which is excluded, despite presenting a positive margin on an annual basis in 2014.

Bearing in mind that ANACOM's determination of 20.06.2013 provides that the USP must justify not taking into account relevant services that, although not profitable on a multi-annual approach on a cumulative basis, present however on an annual approach a

positive margin for any of the years at stake, AXON analysed the justification presented by MEO, having concluded that the exclusion conducted is reasonable and complies with ANACOM's determination, not least because not taking the service concerned into consideration involves only 0.8% of the total margin for 2014, having AXON taken the view that this element has but a negligible impact in the calculation of CLSU.

Still on this subject, AXON mentions that the determination of relevant services was based on total values for 2014 instead of the five months during which the service was provided, referring that MEO justifies the use of total values of the year given that the CAS - the source used to make the calculation - is only updated on an annual basis, and, consequently, the calculation of accurate margins is only possible for an annual period. AXON concludes that the use of values for the whole year is a reliable proxy for the value of each service in the five months concerned, and leads to the same conclusions.

As regards the annualisation of one-off revenues and costs, the audit report refers that MEO annualised one-off revenues/costs by applying the 5/12 proportion (revenues/costs up to May) to the amount concerning the deferral concerning each of the years from 2010 to 2013, and the proportion of 1/5 to 2014 revenues/costs occurred up to May 2014. Auditors consider this approach followed by MEO to be consistent with the methodology approved by ANACOM.

As far as the implementation of other general principles is concerned, auditors checked the approach followed by MEO and considered it to be in line with the methodology established by ANACOM, not having been identified any situations that justify the amendment of values presented.

MEO comments

In its comments, MEO mentions that, in the identification of relevant services, margins presented by auditors, in the audit report, do not include the full costs established in the CAS, as curtailments costs were not considered, and in the opinion of this operator, the assessment of the total margin of a given product or service must take the full costs into consideration.

This operator believes that the inclusion of curtailments costs in the determination of margins could change the conclusion they point towards, and mentions that this occurred already for the 2013 financial year as regards the service identified in the audit report with

positive margin on an annual basis in 2014, claiming that this alters conclusions reported in the fourth paragraph of page 33.

Line taken by ANACOM

Bearing in mind the positive assessment presented by AXON on how MEO implemented the general principles, and the conclusion set out in the audit report, whereby the approach followed by the company is consistent with the methodology defined by the Regulatory Authority, ANACOM takes the view, as far as the general principles are concerned, that MEO has implemented the CLSU calculation methodology correctly. This assessment includes the correct implementation of ANACOM's decision of 22.07.2015 on inputs to be used for the calculation of 2014 CLSU. In this respect, it must be noted that, according to ANACOM's determination, it has been safeguarded that average unit costs obtained on the basis of annual CAS data are not significantly different from average costs of the period under consideration, thereby guaranteeing that the model and its results appropriately portray the reality. In this respect ANACOM highlights, in particular, the analysis conducted by AXON, monthly costs contained in MEO's general accounting and costs taken into account in the establishment of CLSU, which allowed the Regulatory Authority to ascertain that the accumulated difference of such costs in the January-May period of 2014 is a mere 0.04%.

It is noted that in the audit to values resubmitted in May 2016 by MEO, AXON did not identify any alterations with impact on its conclusions, whereby ANACOM's opinion, expressed in the paragraph above, is maintained.

At the level of the establishment of relevant services, the audit report presents the analysis of the profitability of services provided outside the US on US accesses on a cumulative basis as well as on an annual basis. It was found that, in the period considered, in case an exclusively annual approach was followed, an additional service should have been considered, however the margin of that service has but poor representativeness compared to the margin of all services deemed to be relevant, given that it shows, as referred in the audit report, a negligible impact. It is also referred that the audit report presents, according to ANACOM's determination, MEO's justification for not including the referred service, having auditors taken the view on the matter that "(...) MEO followed ANACOM's determinations appropriately."

In the light of the above and also of the conclusion of auditors on the determination of relevant services, according to which the “(...) *exclusion is reasonable, and in line with ANACOM's determinations*”, ANACOM considers that MEO's approach leads to similar results to those that would be obtained with an annual approach and presents greater consistency at methodological level. As such, MEO's approach is accepted.

As regards MEO's comment on whether curtailment costs should have been taken into account in the calculation of the margin for the purpose of the establishment of relevant services, it must be mentioned that the referred costs result from MEO's human resources policy and strategic options, and as such are not affected by the termination of the provision of unprofitable services, and, consequently, are not directly related to the US provision. For this reason, it is deemed that they should not be included in the scope of relevant services, being stressed that, in fact, they were not taken into consideration.

3.2. Avoidable costs associated to the provision of connection to the public telephone network at a fixed location and access to publicly available telephone services, and to the provision of public payphones

This section focuses on how avoidable costs are established, whereby the specificity of the calculation of 2014 CLSU (inputs used in this calculation for the purpose of obtaining data for the January-May period of this year) has already been dealt with in the preceding chapter.

The establishment of CLSU associated to the obligations of connection to the public telephone network at a fixed location and access to publicly available telephone services through that connection, and of the public payphone service, starts by determining the avoidable costs and lost revenues in each of the considered geographical areas in case the service provision was discontinued therein.

In this context, the methodology explains that avoidable costs per access are determined, for each Main Distribution Frame - MDF, in the framework of MEO's regulatory accounting system, all costs requiring a thorough examination to ascertain whether they should be classified as avoidable or not. For the purpose of CLSU calculation, only costs which are effectively related to access and which would be avoided (cease) on the moment a certain area was discontinued, are taken into consideration.

The methodology further refers that, where the USP demonstrates in a justified fashion that it lacks detailed information to identify costs effectively allocated to accesses, that are avoidable, it may use alternative approaches for breaking down costs by MDF, namely by using cost breakdown functions. Notwithstanding, approaches adopted must be without prejudice to the final target of ensuring the due reliability of costs considered for each MDF and the portrayal of their specific characteristics.

3.2.1. Establishment of avoidable costs and of avoidability ratios

AXON's Audit Report

The establishment of avoidable costs in the access to each geographic area is based on the identification of relevant costs, the calculation of avoidable costs and the geographic breakdown of costs.

The calculation of avoidable costs - costs incurred by MEO which could be avoided where it was not under the duty to fulfil US obligations - is conducted on the basis of estimates of avoidability of cost components. The degree of avoidability of the cost of components is separately determined on the basis of avoidability ratios where the service was interrupted in an MDF area and for individual customers.

AXON indicates that, in the absence of disaggregated information on costs that are effectively avoidable, MEO opted, in order to calculate these avoidable costs, to use an approach based in Long Run Incremental Costs (LRIC), as the company considers that incremental costs provide a meaningful proxy for avoidable costs. This approach has in fact been used in previous years to establish CLSU.

Given that MEO does not hold a LRIC model to establish avoidable costs for the various services (at access and traffic levels), AXON refers in the audit report that MEO uses LRIC ratios vs. Fully Allocated Costs (FAC) based on external information provided by British Telecom (BT) and Eircom.

AXON further specifies in its report that, in this calculation, MEO also uses statistic regressions of operational and financial indicators of US operators from the United States

of America (USA), based on data provided by the Federal Communications Commission (FCC).

AXON concludes that, according to its experience in similar contexts, avoidability ratios adopted by MEO to establish avoidable costs are reasonable. Moreover, AXON stresses that the main external data sources adopted, especially BT and Eircom, are deemed to be reputable and credible references.

Line taken by ANACOM

Bearing in mind ANACOM's agreement with how MEO established avoidable costs in the scope of the determination of CLSU in previous years, and taking into account that the approach followed in the determination of 2014 CLSU is the same as that followed in the determination of CLSU from 2007 to 2013, as results from the audit report, ANACOM deems such approach to be sufficiently substantiated, and also avoidability ratios and the calculation of avoidable costs used by MEO to be appropriate.

3.2.2. Geographical de-averaging of access costs

Audit Report

MEO refers that due to constraints on information systems, the identification of individual assets and associated cost values required to implement ANACOM's methodology determination is not feasible. As such, and as provided for in the methodology approved by ANACOM, MEO presented an alternative approach to calculate avoidable costs per MDF, in line with the approach followed for CLSU of previous years.

The audit report mentions that MEO's approach consisted in the use of operational data and reference prices to de-average access costs according to MDF. Traffic costs do not materially differ according to geographic areas, and as such are not included in the de-averaging process.

According to the audit report, operational information was validated using data for 2014, and auditors did not find any abnormal situations when comparing this information with information considered in the model.

As such, auditors conclude that they did not identify any relevant aspects in the implementation of the approach followed by MEO, deeming that it is consistent with the

methodology approved by ANACOM. In addition, they mention that conclusions remain valid in the analysis to results resubmitted by MEO in May 2016.

Line taken by ANACOM

Just like in CLSU calculation of previous years (2007-2013), MEO declares that it lacks information in its systems, with the degree of required breakdown, to calculate access costs per MDF according to ANACOM's determination, namely as regards information on the value of asset acquisition, year of acquisition, useful life, accumulated depreciation and net value of assets.

It is noted that, in the light of the calculation methodology approved by ANACOM, the use of alternative approaches for establishing access costs per MDFs is permitted, insofar as this is without prejudice to the final objective of ensuring a due reliability of costs considered in each MDF and the consideration of their specific characteristics.

In addition, auditors validated the absence of information on the part of MEO allowing it to determine avoidable access costs without the use of alternative approaches, due to difficulties in identifying costs effectively allocated to accesses.

AXON concludes that the approach followed by MEO is consistent with the methodology defined by ANACOM, not having been found any elements that call its reliability and its correspondence to reality into question.

Bearing in mind AXON's conclusions, ANACOM considers that the alternative approach followed by MEO is sufficiently substantiated and is acceptable, not having been found any elements that call its reliability and its correspondence to reality into question.

3.3. Unprofitable areas (establishment of FTS and PPP costs)

This section focuses on how unprofitable areas are determined, whereby the specificity of the calculation of 2014 CLSU (in particular as regards operational and financial inputs used in this calculation for the purpose of obtaining data for the January-May period of this year) has already been dealt with in chapter 3.1.

The methodology defines that the establishment of unprofitable areas takes place by identifying areas with negative profitability.

Subsequently, having stabilized the number of geographical areas classified as being potentially unprofitable, that is, areas that show negative profitability in a given year, the methodology defines the application of two additional criteria, in order to strengthen the model of determination of unprofitable areas and to increase its correspondence to reality: i) the criterion associated to multiannual profitability and (ii) the criterion of existence of an effective competition.

The first criterion, of multiannual profitability, consists in identifying unprofitable areas based on their profitability since 2007 up to year for which CLSU are determined, and only areas which remain unprofitable in all years concerned are deemed to be unprofitable areas.

The second criterion, of the existence of an effective competition, consists in excluding unprofitable areas where there are at least two collocated operators from the calculation of CLSU. The year for which a larger number of collocated operators per MDF is recorded, between 2007 and the year to which CLSU refer, is used as reference.

Moreover, taking into consideration that in the methodology for calculation of CLSU, in the establishment of unprofitable areas, costs associated to unprofitable public payphones are accounted for together with FTS costs, ANACOM established, in its determination of 22.07.2015 and for the purpose of the calculation of 2014 CLSU, that in these areas net costs for each of these offers (FTS and PPP) must be calculated in separate. As such, on the basis of results obtained separately for FTS and PPP, the proportion of each component in the net cost associated to unprofitable areas is then determined, this proportion being applied to broad results of the "area model" obtained in the calculation of profitable and unprofitable areas and of the net cost of the latter up to 31.05.2014, assuming that MEO would be the FTS and PPP USP, so as to establish the contribution of each of the components (FTS and PPP) to the net cost of unprofitable areas.

As regards the value of CLSU allocated to PPP, given that MEO only provided the service up to 08.04.2014, a pro-rata is performed taking into account the period up to which MEO was the PPP USP prior to the tender designation, which corresponds to multiplying the obtained value by 98/151 days.

AXON's Audit Report

The audit report mentions that in the application of the criterion associated to multiannual profitability, MEO considered as unprofitable areas, in estimates submitted on 30.10.2015, areas which in preceding years had been considered to be profitable. Auditors thus recommended MEO to correct this situation and to recalculate CLSU. Auditors estimate the correction of this situation to have resulted in a decrease of CLSU by 9,062€.

AXON mentions also, in the same audit report, that MEO did correct this situation, when estimates for the calculation of 2014 CLSU were resubmitted (in calculations submitted both on 27.01.2016 and on 06.05.2016).

As regards the criterion of existence of effective competition, AXON refers that no area was excluded on account of the application of this criterion.

AXON further mentions that MEO applied correctly the calculation methodology established in determination of ANACOM of 22.07.2015, having established CLSU obtained separately for each of the components (FTS and PPP) and applied a pro-rata of PPP bearing in mind the date up to when MEO was the PPP USP.

AXON thus concludes that the approach followed by MEO in the establishment of unprofitable areas in resubmitted results is consistent with the methodology determined by ANACOM, including with provisions set out in decision of 20.06.2013, on the results of the audit to CLSU for the 2007 to 2009 period, where amendments were determined to multiannual profitability and competition criteria, and in decision of 22.07.2015, on the methodology of calculation to be applied for 2014.

Notwithstanding, AXON identifies some issues at the level of the reconciliation of inputs of the model with values in the CAS, concerning traffic volumes, values of access and traffic revenues as well as with the number of access lines, issues which are dealt with below in section 3.8.

Moreover, AXON identified, in the scope of the work on the reconciliation of inputs, a relevant situation concerning installation revenues considered in the model. According to clarifications provided by MEO, this corresponds to a calculation error, given that the company had failed to consider the effect of the five-year deferral in discounts of installations. This situation was corrected by MEO when it resubmitted estimates of

calculation of 2014 CLSU, in calculations submitted both on 27.01.2016 and on 06.05.2016.

MEO comments

In its comments to the audit report, MEO confirmed the existence of situations identified by AXON on the application of the criterion of multiannual profitability and failure to defer, for a five-year period, the value of the discount allocated to installations for 2014, referring that it had corrected these situations in the calculation of 2014 CLSU submitted on 27.01.2016.

The company adds, in its comments to the chapter of the audit report on the model of unprofitable areas, that it had identified a mistake in *table 4.14: Revenues per access services resulting from CAS and the Model of Unprofitable Areas*, indicating that the CAS value on installation of leased lines with speed below 2Mbits is not correct, revenues for 64K leased lines not having been included.

Line taken by ANACOM

In the scope of the audit work to the area model, AXON identified two situations with impact at the level of CLSU calculation: the first associated to the application of the criterion of multiannual profitability, involving the determination of unprofitable areas (namely taking account of unprofitable areas which had been considered in previous years to be profitable) and another associated to the calculation of installation revenues (calculation error of the deferral to be considered). The audit report describes these occurrences and presents recommendations set out by auditors to rectify them, further mentioning that in the resubmission of CLSU values for 2014 MEO implemented the recommendations.

Taking into account that auditors validated the implementation by MEO of specific determinations laid down by ANACOM on 22.07.2015 as regards steps to be followed to establish CLSU in unprofitable areas for the FTS and PPP components, it is deemed that the approach followed by MEO is appropriate and in accordance with the methodology defined.

Finally, it is clarified that AXON corrected the mistake identified by MEO in table 4.14 of the audit report, a change which has no impact on conclusions.

3.4. Unprofitable customers in profitable areas (FTS)

After unprofitable areas have been determined, the methodology determines that unprofitable customers in profitable areas must be identified. As such, customers whose revenue is insufficient to cover the respective costs, and customers that present high individual access costs that exceed the generated revenue, even if such revenue is equal to or higher than the national average, must be identified, whereby the former are not be considered for the purposes of CLSU calculation, except where these customers show unusually high access costs⁷.

The calculation of CLSU associated to unprofitable customers in profitable areas is based on an approach similar to the one used to determine unprofitable areas, avoidable costs and lost revenues being identified. The methodology established by ANACOM provides also that, in the absence of detailed information of the breakdown of costs, alternative approaches may be used to determined avoidable costs.

In the scope of the decision on the MEO for calculation of CLSU to be applied in 2014, it was determined, as far as unprofitable customers are concerned, that results obtained in the model of unprofitable customers in profitable areas would be fully allocated to the FTS component without the need for any amendments.

3.4.1. Adjustment for the purpose of the accounting of traffic between unprofitable customers in profitable areas

When resubmitting new estimates of 2010-2011 CLSU, MEO conducted a review of the adjustment to avoid double counting traffic between unprofitable customers in profitable areas, so as not to compromise the correspondence of the model to the reality portrayed. In that occasion, the company referred that the need for the review resulted from the change of MEO's net margins resulting from the review of CAS values.

MEO thus calculated the proportion of revenues of unprofitable customers in the total of revenues of on-net calls made in profitable areas on the basis of gross revenues instead of net revenues.

⁷ The determination of 12.10.2012 focused on the development of the concept of unusually high access costs in the scope of the methodology to be applied for the calculation of CLSU, having been established, for this purpose, that costs of customers included in the last third of customers with the highest costs must be taken into consideration.

In its decision on the establishment of 2010-2011 CLSU, of 20.11.2014, ANACOM considered that this change increases the strength of the calculation and that it is in accordance with the established methodology, noting also that auditors considered it to be reasonable and appropriate.

AXON's Audit Report

The audit report mentions that the calculation of the net revenue adjustment, intended to eliminate the double counting of on-net received and made calls in the scope of the 2014 CLSU "(...) *is based on the percentage that unprofitable customers represent in the total of gross revenues of on-net calls made in those unprofitable areas.*"

AXON reaches the conclusion that the approach followed by MEO is consistent with the methodology established by ANACOM.

Line taken by ANACOM

In this respect, it must be stressed that, having ANACOM approved on 20.11.2014, in the scope of the decision on 2010-2011 CLSU, the adjustment proposed by MEO, and bearing also in mind that auditors considered it to be reasonable and appropriate, and that in the decision on 2012 CLSU ANACOM maintained this approach and clarified that the adjustment should be maintained in future years, a view which was maintained for 2013 CLSU, it is deemed that the adjustment conducted by MEO in 2014 CLSU is in compliance with ANACOM's determinations.

3.4.2. De-averaging access costs according to customers and de-averaging net revenues

AXON's Audit Report

It is referred in the audit report that MEO claims that it is not feasible to individually identify unprofitable customers due to internal limitations of its information systems. It is expressly mentioned that the access cost depends on operational information, namely the loop length, which is not available for all accesses, thereby making the correspondence between physical access lines and customer identifiers impossible.

As a result, MEO followed an alternative approach to identify unprofitable customers in profitable areas, which AXON explains in detail in the audit report and which involves the

elaboration of de-averaging curves of net revenues and of access costs. On the basis of these de-averaging exercises, MEO is able to calculate the proportion of customers that are not profitable in each area and net costs generated by such customers.

As regards the de-averaging of access costs, auditors mention that the model uses data for 2014 and that the de-averaging of line length took only retail lines into consideration, in compliance with ANACOM's determination on this matter.

As such, AXON concludes that the approach followed by MEO is consistent with the methodology established by ANACOM, a conclusion which is restated for results resubmitted by MEO in May 2016.

Notwithstanding, auditors identified in the first values submitted by MEO on 30.10.2015 a situation at the level of calculation, the correction of which was recommended. In one of the sheets of the customer model some items were calculated taking the annual period (12 months) into consideration, when only the period of service provision (5 months) should have been considered. These calculations are deemed not to have any impact in the model of unprofitable customers or in the final value of 2014 CLSU, given that sheets used as basis for the calculation of 2014 CLSU correctly consider the 5-month period; nevertheless, the correction was recommended. The audit report also mentions that when 2014 CLSU estimates were resubmitted, MEO had corrected this situation.

MEO comments

In its comments to the audit report of 2014 CLSU, MEO mentions that it agrees with the recommendation made by auditors as regards to need to consider the 5-month period instead of the 12-month period in the calculation model, referring that it conducted this correction in calculations resubmitted on 06.05.2016. It stresses, just like auditors, that the implementation of this correction had no impact on CLSU results.

Line taken by ANACOM

As was the case with the determination of CLSU in previous years, MEO declares that it is not provided with disaggregated information on access costs and follows the alternative approach implemented in previous years.

Bearing in mind that ANACOM agreed with the approach followed by MEO in the scope of the determination of CLSU in previous years and taking into account that auditors

conclude, in the scope of this audit, that the approach followed by MEO is consistent with the methodology established, ANACOM concludes that the process followed is in compliance with the methodology.

Taking also into consideration that when resubmitting CLSU values for 2014, MEO implemented the auditor recommendation referred above, according to the mention made in the audit report, ANACOM considers that there is nothing to point out.

3.4.3. Determination of unprofitable customers with unusually high access costs

AXON's Audit Report

The audit report refers that MEO identified customers with unusually high access costs taking into consideration the last third of customers with the highest access costs at national level, in compliance with ANACOM' determinations.

Line taken by ANACOM

ANACOM believes that the identification of unprofitable customers with unusually high access costs was conducted in line with the methodology, as validated by AXON.

It is noted that in the scope of the audit to values resubmitted by MEO, no changes were introduced with impact on this view.

3.5. Retired persons and pensioners

The methodology for calculating CLSU refers that the net cost resulting from this offer corresponds to the value of the discount associated to the US pricing for "Retired Persons and Pensioners", taking into account the effect of price elasticity of demand. The determination of 25.11.2011 approved the value of the price elasticity of demand for the purpose of the calculation of CLSU associated to retired persons and pensioners.

MEO's approach consists in obtaining an average monthly number of "retired people and pensioners" in each year on the basis of annual information contained in its financial records at the level of the total invoicing associated to "retired people and pensioners".

This approach has been accepted by ANACOM in the scope of previous audits.

In the scope of the decision on the methodology for calculation of CLSU for 2014, no amendments were made to how calculations were made, having been established that the full costs allocated to retired persons and pensioners must be taken into account in the FTS component.

AXON's Audit Report

The audit report describes the approach adopted by MEO and mentions that the calculation of CLSU for 2014 took into consideration accounting values and operational data for the first five months of the year.

Auditors conclude that the approach followed by MEO and its adjustment for 2014 is consistent with the methodology established by ANACOM, whereby AXON has not found situations to report in terms of verification of calculations or review of inputs.

Line taken by ANACOM

Taking into account the conclusion presented by AXON on the consistency of the approach followed by MEO with the methodology established by ANACOM, it is deemed the process followed is in compliance with ANACOM's determinations.

3.6. Provision of public payphones in profitable areas

According to the methodology for calculation of CLSU, the calculation of costs associated to public payphones takes only into consideration unprofitable public payphones in profitable areas, given that costs associated to public payphones in unprofitable areas are integrated in the component of FTS access. Notwithstanding, in the scope of amendments to the establishment of 2014 CLSU, it was determined, as already referred in chapter 3.3, that in the scope of results of unprofitable areas, the FTS and PPP offers would be calculated in separate, as these costs must be autonomized. After components are calculated, the proportion of each in the net cost associated to unprofitable areas is then determined, this proportion being applied to broad results of the "area model" obtained in the calculation of unprofitable areas (costs up to 31.05.2014). Subsequently, a pro-rata is performed to determine PPP costs in unprofitable areas, taking into account the period up to which MEO was the PPP USP prior to the tender designation (08.04.2014). This issue was dealt with in chapter 3.3.

It is noted that the methodology used to determine CLSU of PPP is also based (just like the method used to obtain costs for the FTS) on the establishment of avoidable costs and lost revenues, unprofitable public payphones being deemed to be those the avoidable access costs of which exceed lost revenues.

It must be referred that in the scope of the decision on the methodology for calculating 2014 CLSU, ANACOM determined, as regards the public pay-phone model (costs of unprofitable PPP in profitable areas), that no alterations were required, whereby results obtained using that model should be fully allocated to that component.

AXON's Audit Report

Auditors concluded, in the audit report, that the approach followed by MEO was consistent with the methodology determined by ANACOM, a conclusion which was restated in the audit to results resubmitted by MEO.

Notwithstanding, recommendations were made as regards the reconciliation of traffic and revenue volumes considered in the calculation of CLSU with values in the CAS, an issue which will be dealt with below in section 3.8.

In addition, AXON found a calculation error in the public payphone model. Auditors noted that MEO, in estimates presented on 30.10.2015, considered in the public payphone model a 12-month time frame, when a five-month period should have been considered. Auditors recommended the correction of this situation, and confirmed that it was corrected both in results resubmitted on 27.01.2016 and those conveyed on 06.05.2016.

MEO comments

In its comments to the audit report, MEO acknowledged the mistake identified by auditors at the level of the time frame considered, and mentioned that it rectified that situation in the calculation of CLSU for 2014 sent on 27.01.2016.

It identified in addition a mistake in the audit report at the level of the value concerning the margin of unprofitable public payphones in profitable areas in a paragraph of chapter 6.1. Overview of results.

Line taken by ANACOM

In the light of the conclusion presented by AXON on the consistency of the approach followed by MEO with the methodology defined by ANACOM, it is deemed that the process followed is in accordance with ANACOM's determinations.

As regards the calculation mistake identified by auditors, estimates resubmitted by MEO reflect the implementation of the recommendation made by AXON to correct it, which auditors confirmed in the audit report, thus ANACOM takes the view that identified issues, in this context, have been overcome.

Lastly, in respect of the mistake identified by MEO in the audit report, it is clarified that the value in the paragraph concerned did not correspond to the value of the margin of unprofitable public payphones in profitable areas and, as such, AXON corrected this situation in the final report on 2014 CLSU.

3.7. Indirect benefits

ANACOM's methodology includes as indirect benefits, to be deducted in order to obtain the final value of CLSU, benefits concerning the corporate reputation and brand enhancement, ubiquity, advertising on public payphones, mailing and regulation fees.

In the scope of the determination of 22.07.2015, on the methodology of calculation of CLSU for 2014, adjustments were made to the calculation of some indirect benefits, and it was also defined how the allocation to each component (FTS and PPP) should take place. As such, it was determined that:

- The "*corporate reputation and brand enhancement*" indirect benefit should be allocated to the two US components according to the proportion of the number of unprofitable accesses for each of these components, compared to the range of unprofitable accesses.
- The "*ubiquity*", "*mailing*" and "*regulation fees*" indirect benefits should be fully allocated to the FTS component.
- The "*advertising on public payphones*" indirect benefit should be fully allocated to the public payphones component.

AXON's Audit Report

AXON concludes as far as benefits are concerned that the approach followed by MEO complies with the methodology established by ANACOM, not having been identified any irregular situations at the level of the review of calculations and of inputs.

As such, as regards the “*corporate reputation and brand enhancement*” indirect benefit, AXON found that the calculation was performed according to the methodology defined and that the benefit was differentiated between the FTS and PPP services on the basis of the number of unprofitable accesses for each of these components, having been applied a correction factor as regards the benefit to be allocated to public payphones (98/151 days), due to the date up to which MEO was the USP under the regulatory framework for the period preceding the USP tender designation.

As regards the “*ubiquity*”, “*mailing*” and “*regulation fees*” benefits, AXON confirms that the respective values were correctly determined, having been fully allocated to the FTS component, as determined by ANACOM, and taking into consideration the period in which the offer was ensured by MEO (from 1 January to 31 May 2014).

As far as the “*advertising on public payphones*” indirect benefit is concerned, auditors conclude that its determination complied with ANACOM's determinations, as it only took into account the public payphones component, and a 98/151 pro-rata was applied, so as to relate to the period in which the offer was provided (from 1 January to 8 April 2014).

Line taken by ANACOM

In the light of the conclusions presented by AXON on the consistency of the approach followed by MEO with the methodology defined by ANACOM, it is deemed that the process followed complies with ANACOM's methodology.

3.8. Reconciling the number of lines and traffic and revenue volumes considered in the calculation of CLSU with values entered in the CAS

AXON's Audit Report

The audit report identifies some problems in reconciling values from the CAS and those considered in the calculation of CLSU. Auditors note that the same reconciliation problems were identified in the calculation of CLSU in previous years.

As such, just as in the scope of previous audits to CLSU results, AXON identified difficulties in reconciling the number of access lines (PSTN/ISDN) considered for the purpose of the calculation of CLSU of unprofitable areas and of unprofitable public payphones with volumes entered in the CAS for 2014. Auditors also indicate that the number of lines included in the calculation of CLSU is lower than the one in the CAS, which in its opinion undervalues CLSU values.

The audit report also mentions deviations at the level of traffic volumes and of revenues, affecting the calculation of unprofitable areas and specifically of unprofitable public payphones in profitable areas. Although it is acknowledged that this situation limits the accurateness and resilience of amounts presented and calculations made by MEO, auditors conclude, taking into account that volumes considered for the purpose of CLSU calculation are generally lower than those reflected in the CAS and that revenues considered in the model and generally higher than those reported in the CAS, that MEO is underestimating CLSU.

As regards deviations identified in the reconciliation of traffic volumes, the audit report takes due note of the clarification provided by MEO, stressing the fact that traffic values used in the calculation of CLSU are lower than those in the CAS. This operator refers that the volumes considered in the calculation of CLSU should not be compared directly to volumes reported in the CAS, as the traffic volume reported in the CAS includes traffic of customers at the level of analogue accesses and RDIS accesses, as well as traffic of IPTV and VoIP customers, which are not included in the calculation of CLSU. The difference between volumes of traffic between the public payphone model and the volume reported in the CAS, according to the clarification provided by MEO to auditors, is related to the fact that volumes of virtual cards included in the CAS correspond to paid minutes, whereas minutes included in the model correspond to minutes effectively routed in the network.

As regards differences found in the reconciliation of access and traffic revenues in the model of unprofitable areas, the audit report presents clarifications provided by MEO on this situation. According to this operator, the main reason for this deviation results from the fact that the CLSU model does not take into account the discount granted to customer accounts as it was not possible to allocate the discount to each service. As regards differences in the reconciliation of revenues allocated to public payphones, the clarification provided by MEO, referred in the audit report, explains that this situation occurs because revenues of virtual cards in the CAS were adjusted for financial accounts that present a lower value than that presented in operational systems.

MEO comments

In its comments to the audit report, MEO restates the observations made in the scope of previous audits to CLSU. As such, at the level of the number of lines used to calculate CLSU, it stresses, as declared by AXON, (...) *that, taking into account the fact that the number of lines considered for the purpose of the calculation of CLSU, is in general much lower than the value reflected in the CAS, the establishment of CLSU performed by MEO is underestimated*".

As regards factors which prevented the full reconciliation of traffic volumes and volumes of access and traffic revenues, it declares that a full reconciliation of values should not be expected, stressing that factors that made the full reconciliation impossible in previous years (2007-2013) remained in 2014. Lastly, the company declares that volumes of minutes used to establish 2014 CLSU are lower than those in the CAS, which undervalues CLSU, and that revenues considered in the CLSU model are higher than those in the CAS, which on its turn also leads to the underestimation of established CLSU.

Line taken by ANACOM

As regards deviations identified in the reconciliation between values considered in the CLSU calculation model and those in the CAS, it must be referred, in the first place, that in all situations identified this fact contributed to the underestimation of CLSU. In the second place, these situations were duly justified, having auditors undertook an analysis and concluded that data used in the CLSU calculation model result in a more conservative CLSU estimate, and thus affects negatively only MEO itself. In the third place, in the scope of audits to CLSU estimates from 2007 to 2013, this type of deviations had already

been identified, having ANACOM accepted values used for the calculation of CLSU on the basis of arguments set out above.

Not having been identified new elements that call into question this Authority's views, ANACOM reiterates its position. As such, bearing in mind that the situations verified in the reconciliation between some inputs of the model and CAS values result from an impossibility acknowledged by MEO, which affects negatively this company only, it is deemed that 2014 CLSU estimates should be accepted.

4. ANACOM assessment of audit results

In the scope of the audit to 2014 CLSU presented by MEO in October 2015 and corrected in January 2016, further to initial recommendations made by auditors, and subsequently, to values resubmitted by the company in May 2016 following alterations introduced in the CAS, MEO concluded that values resubmitted by MEO, except for reconciliation issues, comply with principles, criteria and conditions determined by ANACOM. This conclusion also includes amendments to the calculation of CLSU that result from ANACOM's decision of 22.07.2015, which adjusted the methodology to the fact that MEO was the provider of the US under the former regulatory framework for part of 2014.

As regards issues on the reconciliation of data on the number of lines, traffic volumes and values of access and traffic revenues, it is stressed that this situation was already reported in previous audits, and that auditors maintain their opinion that these situations underestimate the final value of CLSU. In addition, it is referred that, notwithstanding, MEO's clarifications are acceptable. It is noted that aspects identified in the audit as far as reconciliation is concerned are identified both as regards results initially submitted by MEO on 30.10.2015 and those resubmitted on 06.05.2016, whereby conclusions are maintained.

AXON found also that recommendations made in the scope of the audit work to estimates submitted by MEO on 30.10.2015, as well as the model for the amendment of inputs that results from the recast of CAS results for 2014, had been correctly implemented.

In compliance with the conclusion presented by AXON, ANACOM takes the view that the methodology for calculating CLSU was applied in an appropriate and consistent manner by MEO.

5. Final CLSU values for 2014

The final CLSU value for 2014⁸ for the period before the tender designation of an USP is 7,721,671 Euro, according to AXON's audit report to CLSU estimates presented by MEO, a value which reflects the implementation of recommendations made by auditors to values submitted initially by MEO as well as consideration of recast CAS values for 2014, which were approved by ANACOM on 25.05.2016.

In terms of relevance of each component in the value of net costs (difference between avoidable costs and lost revenue) a distribution similar to the one verified in the preceding year is maintained. The component of unprofitable customers in profitable areas continues to show a higher proportion (53%⁹), followed by the component of retired persons and pensioners, which represents 35% of total net costs, just like in the preceding year. The two remaining components maintain their relative weight: the public payphone component shows a weight by 10%¹⁰ and the component associated to unprofitable areas remains as the one with the lowest relevance - around 2%¹¹.

The following chart illustrates the values of net costs and the weight of each component.

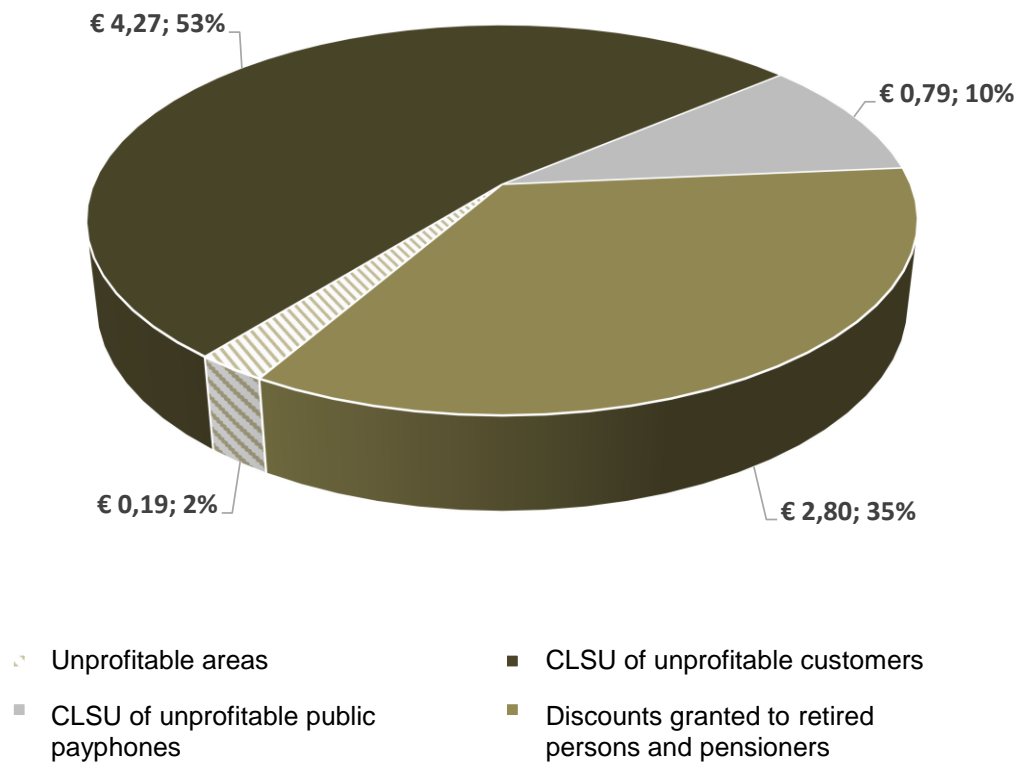
⁸ Reference to 2014 CLSU must be regarded, in this context, as CLSU incurred by MEO between 1 January 2014 and 31 May 2014 for the provision of FTS and between 1 January and 8 April for the provision of PPP.

⁹ In 2013, this component represented 49% of CLSU prior to the consideration of indirect benefits.

¹⁰ In 2013, this component represented 14% of CLSU prior to the consideration of indirect benefits.

¹¹ In 2013, this component represented 3% of CLSU prior to the consideration of indirect benefits.

Chart 1 – Net costs prior to the consideration of indirect benefits, per component, for 2014*



Source: MEO and ANACOM calculations. Values in percentage and million Euro.

* FTS between 1 January and 31 May 2014 and PPP between 1 January and 8 April 2014.

In 2014, the value calculated for the component of unprofitable customers in profitable areas amounts to 4,272,532 Euro. Although it is not possible to compare directly this value with the one obtained for 2013, given that the period of US provision is different, it appears that the number of unprofitable customers in profitable areas has decreased. In 2013 there were 112,619 unprofitable customers in profitable areas and, in 2014, notwithstanding the increase of profitable areas - two more, there is a total of 86,890 unprofitable customers in profitable areas.

The value of net costs associated to the component of retired persons and pensioners corresponds to 2,796,308 Euro and to 98,168 retired persons and pensioners, around less 10% than the number of retired persons and pensioners in 2013 (108,540 retired persons and pensioners).

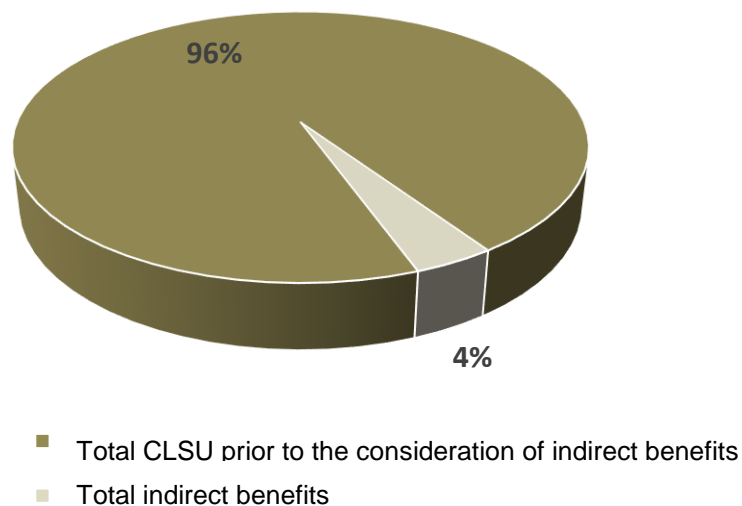
The third most representative component is public payphones, the value of which amounts to 788,751 Euro, whereby the proportion of unprofitable public payphones in profitable

areas, compared to the total of public payphones, slightly increased between 2013 and 2014, although the number of unprofitable public payphones in 2014 decreased compared to the preceding year.

Lastly, the component with the least relevance in the value of net costs before indirect benefits are taken into consideration is the unprofitable areas component, which amounted in 2014 to 190,716 Euro, in a total of 29 unprofitable areas, less two than those in 2013.

As regards the relevance of indirect benefits in the total amount of costs, that is, in the establishment of the value of CLSU, their weight has slightly decreased; in 2014 it represents 4% compared to the 5% verified in the preceding year. The following chart illustrates the weight of indirect benefits in the total of CLSU prior to the consideration of indirect benefits.

Chart 2 – Weight of indirect benefits in the total of CLSU prior to the consideration of indirect benefits

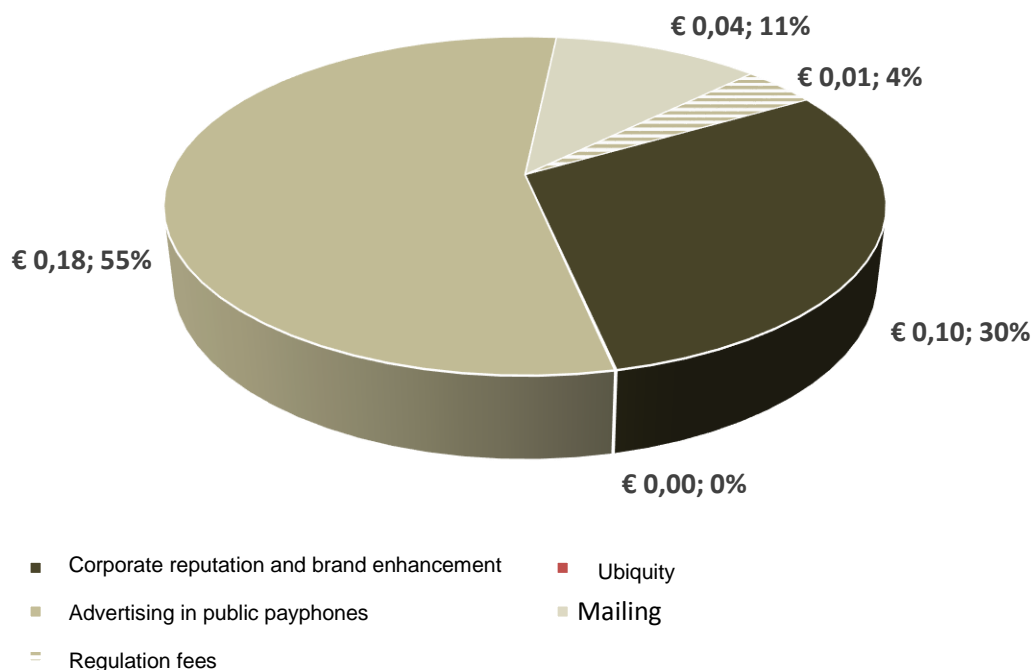


Source: MEO and ANACOM calculations.

In 2014, the value calculated for indirect benefits amounts to 326,636 Euro, whereby the largest indirect benefit continues to be the one associated with “advertising in public payphones”, with a weight of 55%, which is however less representative than in 2013 (61%). Just like in 2013, the second most relevant indirect benefit is “corporate reputation and brand enhancement”, with a weight of 30% compared to 27% in the preceding year.

The “mailing”, “regulation fees” and “ubiquity” indirect benefits maintain a level of representativeness close to that in the preceding year. Mailing is the third most relevant benefit, with a weight around 11%¹², followed by the benefit associated to regulation fees, with a representativeness of 4%¹³, and by the ubiquity indirect benefit with a weight by less that 1%, just like the preceding year.

Chart 3 – Final values for indirect benefits, per type of benefit, for 2014*



Source: MEO and ANACOM calculations. Values in million Euro.

* FTS between 1 January and 31 May 2014 and PPP between 1 January and 8 April 2014

6. Conclusion and Determination

Whereas:

- a) In its preliminary audit report, AXON concludes that, except for limitations related to reconciliation and discrepancies identified in calculations and sources of information, results and calculations presented by MEO in 30.10.2015 (first CLSU estimates for 2014) and later corrected in 27.01.2016, further to some

¹² In 2013, this component represented 9% of indirect benefits.

¹³ In 2013, this component represented 3% of indirect benefits.

recommendations conveyed in the meantime by AXON to MEO, are in compliance with principles, criteria and conditions laid down in ANACOM determinations, and data, assumptions and calculations used are adequate enough.

- b) Before AXON presented its preliminary audit report, MEO conveyed on 06.05.2016 new CLSU estimates for 2014, taking into account recommendations made by AXON in the course of the audit as well as recast CAS values for 2014, which in the meantime had been approved by ANACOM on 21.05.2016.
- c) The referred estimates were subject to a new audit in the scope of the ongoing procedure, which had not been yet concluded. This audit was intended to check compliance of resubmitted values with amendments introduced in MEO's CAS for 2014, and the correct implementation of recommendations set out in the preliminary audit report.
- d) ANACOM notified MEO on 08.06.2016 of final audit results to CLSU estimates for 2014, this company having sent its comments to the final audit report (draft version) on 07.07.2016.
- e) Alternative approaches used by MEO to establish avoidable access costs continue to be acceptable to ANACOM, as they have been used before in the scope of the establishment of CLSU for previous years, having been considered acceptable and consistent with the methodology for calculating CLSU, both by auditors and by ANACOM itself.
- f) In compliance with ANACOM's determination of 22.07.2015, MEO used, to calculate CLSU for 2014, operational data as well as traffic and revenue data for the first five months of the year, having demonstrated that the use of average costs for the 2014 financial year does not differ significantly from the use of unit average costs for the January-May 2014 period, and as such that unit average costs for 2014 appropriately reflect the company's activity for the period concerned.
- g) ANACOM confirms that the methodology used to determine unprofitable areas, including the application of plausibility criteria, as well as to determine unprofitable customers in profitable areas, retired persons and pensioners, unprofitable public payphones in profitable areas, and indirect benefits, is appropriate and complies with ANACOM's determinations.

- h) Limitations identified at the level of the reconciliation of values used to determine CLSU compared to information entered in the CAS for 2014, referred in a), correspond to situations which have been duly justified, and which result in the underestimation of CLSU, in compliance with declarations made by auditors, thus they do not affect other companies, such as those required to contribute to the financing of US, in addition to MEO itself.
- i) Auditors concluded that, except for situations referred as far as reconciliation is concerned, which are able to underestimate the amount of CLSU, all other discrepancies identified in the course of the audit and referred in a) have been corrected, and final values resubmitted by MEO on 06.05.2016 are in compliance with principles, criteria and conditions determined by ANACOM, and reflect also values of the CAS which was reviewed and approved by ANACOM.
- j) In its final audit report, AXON refers specifically that *«(...) the methodology followed by MEO for 2014 complies with the methodology established by ANACOM according to the Applicable Regulatory Framework (...), including with determinations of 20.06.2013, 20.11.2014, on the results of the audits to CLSU for the 2007 to 2009 and 2010 to 2011 financial periods, respectively. This provides soundness, certainty and consistency to total calculations over the years.*
- Moreover, the methodology followed by MEO for 2014 complies with the methodology established by ANACOM specifically for 2014 according to its decision of 22.07.2015 on the "Methodology of calculation of universal service net costs for 2014". »*
- k) The declaration of conformity on the audit to estimates of the universal service net costs for 2014 issued by Grant Thornton refers as follows:

"As such, we believe that, except for situations described in paragraph 10 above, which could underestimate CLSU, recast estimates of net costs of the provision of the Universal Service presented by MEO for the 2014 period preceding the current universal service provision, are in compliance with ANACOM's methodology, assumptions and determinations set out in the Technical Specifications and

amount to 7,721,670.71 Euros (seven million, seven hundred twenty one thousand, six hundred and seventy Euro and seventy one cents.)”¹⁴

- l) The general consultation and prior hearing procedures were held for a twenty-day period, under article 8 of ECL and articles 121 and 122 of the Administrative Procedure Code (Decree-Law No. 4/2015 of 7 January), in the course of which three contributions were received, which were summarized and analysed in the public consultation and prior hearing report, deemed to be integral part of this decision.

- m) Contributions received in the scope of the general consultation and prior hearing procedures restate in essence aspects which had already been referred in the scope of consultations on decisions concerning the establishment of CLSU for previous years, and no new arguments having been put forward, ANACOM maintains unchanged the views expressed in its DD on this matter.

ANACOM’s Management Board, in the scope of assignments conferred under paragraph 1 i) of article 8 of its Statutes, approved by Decree-Law No. 39/2015, of 16 March, in the exercise of powers provided for in articles 95 and 96 of the Electronic Communications Law, hereby determines:

To approve, taking into account the audit result and the declaration of conformity issued by auditors, estimates presented by MEO – Serviços de Comunicações e Multimédia, S.A., on 06.05.2016, and to determine that final CLSU values for the 2014 period preceding the current universal service provision are those set out in the table below.

Table 1 - Final CLSU values for the 2014 financial year (Euro)

	2014
CLSU	7,721,670.71

¹⁴ It is noted that paragraph 10 referred to in the declaration of conformity concerns the identified reconciliations differences.