January 2007

ETNO Reflection Document

- **on the draft ERG Common Position on best practice in bitstream access remedies (ERG (06) 69) and**
- **the draft ERG Common Position on best practice in wholesale unbundled access including shared access (ERG (06) 70)**

Executive Summary

ETNO calls into question the policy "objectives" identified in the ERG draft common positions. It is unclear how these objectives have been established and how they relate to the objectives and principles of the EU Regulatory Framework for electronic communications and to the relevant articles of the EU Access Directive in particular.

ETNO is very concerned with a number of the specific proposals for remedies to be applied on the markets for wholesale broadband access and unbundled local loops. There is a lack of economic analysis of the possible conditions of competition, including the interaction between remedies on different wholesale markets and of the effects of the proposed remedies on competition and investment in the field of broadband.

ETNO invites the ERG to withdraw the proposed drafts and, if at all, continue the process with new proposals that are based on the objectives of the EU Directives in place and that respect the principle of proportionality of regulatory intervention which is one of the main principles of the EU legal framework[i].

I. Introduction [1]

ETNO would like to recall that under the current 'New regulatory framework' (NRF), national regulatory authorities (NRAs) are under a duty to analyse the wholesale markets for broadband access and unbundled local loops (ULL) and, in the absence of effective competition, to apply appropriate and proportionate remedies.

Even more than for earlier ERG documents on remedies, ETNO has grave concerns whether the proposed drafts on further "best practice" remedies papers on bitstream access and local loop unbundling (LLU) will result in meaningful and proportionate guidance on remedies in the chosen market areas for the reasons laid out below. On the contrary, they illustrate a growing bias towards regarding regulation no longer as a means but as an end in itself.

> As highlighted in detail in our comments on the revised *Common Position on the imposition of remedies under the EU Regulatory Framework* (ERG (06) 33), ETNO is of the opinion that the ERG policy recommendations in the field of remedies have so far proven inadequate to promote a targeted and proportionate application of remedies in the EU electronic communications sector. ETNO Members -- and also a number of mobile network operators and other stakeholders -- have called into question both the general approach and the detailed recommendations of the ERG common position on remedies. ETNO invites ERG to acknowledge this fact and no longer maintain that the remedies paper was "welcomed by stakeholders", suggesting a wide-spread support which never was expressed by market parties.

ETNO invites the ERG to withdraw the proposed drafts and, if at all, continue the process with new proposals that are based on the objectives of the EU Directives in place and that respect the principle of proportionality and eventually supports the Lisbon goals which is to strengthen the competitiveness of the European economy.

ETNO comments on the general approach to further harmonisation in the field of remedies as contained on the first pages of both PIBs in its comments on harmonisation principles *(reference to ETNO Reflection Document on ERG (06) 67 and ERG (06) 68).*

II. "Objectives" in the ERG drafts vs. objectives of the NRF

The draft documents ERG (06) 69 and ERG (06) 70 contain a number of "objectives" under which the recommended regulatory measures are grouped. As they are identical in both documents, the following remarks are made for both documents.

- **A contestable set of objectives**

[1] BT and TDC do not support this document

It is unclear why a document that is meant to give guidance on the application of the EU Regulatory Framework starts from "objectives" that are neither contained in the Framework nor explicitly or directly derived from it. We only highlight four examples in the following:

1. Assurance of Access – there is no such principle/objective under the NRF as claimed by ERG. The role of regulators is not to provide "certainty of ongoing access on reasonable terms in order to give competitors confidence". Rather, the NRF foresees regular market analyses consistent with the principles and approaches of EU competition law. As a consequence, proportionate access remedies can be imposed which have to be withdrawn as soon as they are no longer warranted to remedy an identified market failure (principle of proportionality). Additionally "(…) *giving competitors confidence* (…)" could be understood as imposing on incumbents the obligation to provide additional infrastructure while obligations imposed in the relevant market should relate to existing resources.

2. Level playing field: the concept of a "level playing field" for all competitors as constructed by the ERG is not stated or implied within the NRF. Nor does the Framework give NRAs a legislative mandate to remedy "an unfair advantage by virtue of economies of scale and scope, especially derived from a position of incumbency". Scale advantages can play a role in the determination of entry barriers and significant market power (SMP). It is a sweeping and disproportionate approach to construct an "objective" to eliminate advantages derived from scale or vertical integration by way of regulatory intervention. Also, the NRF knows no reference to incumbency (or "original sin"). A first consequence of implementing a "level playing field" principle for e-communications firms, if it were established, would be to lift excessive asymmetric access regulation imposed on e-communications network operators as compared to dominant actors in other innovative sectors of the economy such as IT and media.

3. "Avoidance of unfair first-mover advantage": the NRF knows of no such principle. The NRF stipulates that new markets should in principle not be regulated, and this should apply to first mover advantages derived from innovation. At the same time, foreclosure of markets in the long-term should be avoided, either by means of competition law or sector specific regulation. This alleged "objective" and its consequences stipulated by ERG are in fact an inversion of the NRF concept of "newly emerging markets", intended by the legislator to safeguard investment incentives in new networks and services. The focus on retail products of the incumbent is damaging for consumers, in breach of the principle of the NRF to focus on wholesale regulatory measures and contradicting the efforts by the European Commission to achieve some regulatory relief at retail level in the context of the Recommendation on relevant markets (s. below).

4. "Assurance of backhaul from the point of delivery […]": under the NRF, a market analysis on market 12 or 11 should not be guided by an objective that is related to a neighbouring market (here: leased lines).

Rather, a market analysis on the related markets is necessary to impose obligations, where applicable and justified.

5. "Reasonable technical parameters of access" – remedies imposed in connection with this objective should consider not only "commercial" sense and maximization of scope of competition but also should refer to the economic possibilities of the SMP operator.

The documents use numerous terms and concepts which are not common to the NRF terminology and regulatory and competition law practice in the EU and many of its Member States: the extensive use of the term "fairness" – How does this relate to proportionality?; terms like "obstructive and footdragging behaviour" – Does this behaviour, not defined, represent an abuse of a dominant position?; the inversion of the principle of proportionality by claiming that SMP players should not be "arbitrarily permitted to limit forms of access" whereas every obligation of mandated access has to be justified by the NRA, etc.

- **NRF objectives and principles: proportionality and interest of the end-user**

Under the NRF, NRAs are supposed to impose appropriate and proportionate remedies on relevant markets where a position of SMP has been found. The proportionality of a remedy is assessed in the light of the objectives of the framework laid down in Art. 8 Framework Directive as well as the specific provisions of Art. 8 ff. of the Access Directive and the Universal Service Directive Art.17 (2).

In setting up the "objectives" for its work, ERG has throughout the document adopted the perspective of a regulation-based entrant. This is, however, not always in line with the NRF objectives for the imposition of remedies, namely to impose regulatory remedies where this is proportionate and necessary to remedy a specific market failure in the interest of the end-user, cf. Art 8 (3) Access Directive and Art. 8 Framework Directive. Also, the Commissions Guidelines on market analysis and the assessment of SMP highlight "the respect for the principle of proportionality" as a "key criterion" to assess measures proposed by NRAs under the procedure of Article 7 of the Framework Directive and as "well-established in Community law". Thus it is a prerequisite for the imposition of remedies that the means used to attain a given end "should be no more than what is appropriate and necessary to attain that end. The means employed to achieve the aim must be the least burdensome, i.e. the **minimum** necessary.

ETNO notes with great concern that the principle of targeted and proportionate remedies to remedy market failures in the interest of the end-user is abandoned by ERG in favour of interventionist policies which facilitate market entry and support the business models of access-based competitors, reflecting only a fraction of the goals of the Framework.

The focus of competition policy should be on the consumer as highlighted with regard to Art. 82 EC-Treaty in a speech by the Commissioner for Competition, Neelie Kroes:

"I like aggressive competition – including by dominant companies - and I don't care if it may hurt competitors – as long as it ultimately benefits consumers. That is because the main and ultimate objective […] is to protect consumers, and this does, of course, require the protection of an undistorted competitive process on the market."[ii]

The proportionality of remedies under the NRF should continue to be assessed on a case-by-case basis based on national market conditions, subject to Commission comments under Art. 7 (3) Framework Directive and subject to effective judicial review.

Against this background, ETNO has serious concerns about the ERG formulating the present "Best Practice" Common Positions, in that they are based on the flawed assumption that a summary conclusion for proportionate remedies can be reached as if there was a common market analysis determination across the 27 Member States' national markets.

In this regard, we wish to share the concerns raised by ERG in the draft to ERG (06) 68:

"A one size fits all"-approach to regulatory remedies" so the authors "is sup-optimal where national market differences demand different solutions in order to ensure a good deal for consumers right across Europe"[iii]*. There may be instances where it is more efficient to agree a non-harmonised standard over a harmonised inefficient standard (…)"*[iv]

III. Discussion of perceived problems and "illustrative remedies"

1. "Assurance of access"

As highlighted above, the objective as such is not justifiable under the NRF which is characterised by a regular market analysis procedure that is followed by the imposition of remedies to address the market failure identified.

A decision on possible mandated access has to be taken in the light of the criteria of Art 12 (2) of the Access Directive, namely

a) *the technical and economic viability of using or installing competing facilities, in the light of the rate of market development, taking into account the nature and type of interconnection and access involved;*
(b) the feasibility of providing the access proposed, in relation to the capacity available;
(c) the initial investment by the facility owner, bearing in mind the risks involved in making the investment;
(d) the need to safeguard competition in the long term;
(e) where appropriate, any relevant intellectual property rights;
(f) the provision of pan-European services."

For bitstream access, this analysis has also to take into account the availability of LLU in particular areas, which influences the viability of installing competing facilities for providing bitstream access. [v]

It is unclear how the recommendation to provide bitstream access *"at the regional delivery point when possible for all efficient technology options"* has come about. ETNO contests that this will be justified and proportionate in most cases. NRAs have to analyse whether access to a specific technology is justified in the light of the competition situation on end-user market(s) for business and residential users.

2. "Level playing field"

As stated above, it is regrettable that this objective is not clearly derived from the EU Directives. Instead of talking about "unfair advantages" and "obstructive behaviour" it would have been helpful to use the terms "undue discrimination" and/or "abuse of a dominant/SMP- position".

ERG assumes in this chapter that "unless there is evidence" that a non-discrimination obligation is sufficient to alleviate the problems described - which ETNO understand are problems of undue discrimination – NRAs should consider whether additional measures are necessary. However, this is not a justified assumption:

- Firstly, it appears to reverse the principle of the NRF that NRAs have to justify regulatory intervention in the light of market conditions (as reflected in the market analysis procedure of the Framework Directive and proportionality principle). If regulatory measures to ensure non-discrimination are deemed necessary, under the NRF accompanying measures can only be imposed if and to the extent that otherwise a non-discrimination obligation is insufficient to remedy the market failure identified. The burden of proof for imposing regulatory measures stays with the NRA, no matter how ERG words its recommendations.

- Secondly, the draft does not contain a full discussion of accompanying remedies which would affect the enforcement of a non-discrimination obligation such as transparency - which is mentioned - and, as an already very costly and burdensome remedy, accounting separation.

- Thirdly, as far as ERG considers remedies "under other legislation", especially functional separation, it exceeds the scope of its mandate to advise and assist on the implementation of remedies under the NRF.

3. "Avoidance of unfair first mover advantage"

ETNO is seriously concerned that ERG - without deeper analysis - foresees the possibility of far-reaching regulatory intervention in the complex environment of new networks and new retail services.

In this field in particular, actions by regulators have a direct impact on how Europe will cope with the investment challenge posed by new next generation core and access networks. The approach considered by ERG would seriously delay and in many areas impede investments in high-

speed networks in the EU, accentuating the lead of other economic regions such as the United States and Asia over Europe in this field.

- **The decision concerning access to new networks and services should in principle be up to the investor**

It is wholly unjustified to simply assume that "competitors need assurance of wholesale products to provide enhanced downstream services (eg high-speed internet access)". As a principle, no access regulation should apply to "new downstream services" (wording used in the "illustrative remedies" column on p. 5 of ERG (06) 69) in line with the principle that newly emerging markets should not be subject to inappropriate regulation.

> *"New and emerging markets, in which market power may be found to exist because of "first mover" advantages, should not in principle be subject to ex-ante regulation."*[vi]

The decision over access to new networks and services should in principle be up to the investor. Any decision whether to impose an access obligation to new and enhanced infrastructure must take into account the criteria listed in Art. 12 (2) Access Directive, namely the feasibility of installing competing infrastructures and the risk involved in the investment as well as the NRF objective to promote efficient investment in infrastructure and innovation. Such analysis would have to consider the degree of competition from other existing platforms, plummeting technology costs lowering barriers to alternative market entry, regional differences in provision of services etc.

ERG seems to expect access regulation to automatically cover new and enhanced services and infrastructures. This indicates the huge discrepancy that exists between the perception of the authors and of international investors and most market players regarding the current investment challenges facing the European information society.

"Alternative" operators are often already proving they are ready to invest in new and enhanced services and infrastructures rather than seeking regulated access. This indicates that NRAs will have even more than in the past to finely analyse objective entry barriers , rather than relying on off-the-shelf "best practices". The consumer will otherwise be harmed as investments in new technology will be delayed or limited because of the threat of immediate regulation without an appropriate analysis of costs and benefits for the consumer in the medium to long term.

- **"Equivalent downstream service" guarantee for competitors amounts to excessive retail regulation**

We strongly urge ERG to dismiss the notion that

> "*An appropriate method of control could be an obligation not to make available to itself the wholesale inputs which permit introduction of a new or enhanced downstream service until the corresponding wholesale service components required to deliver an equivalent competitive downstream service [..]e*"

This concept of "replicability" for competitors of new downstream products proposed by the ERG would distort investment decisions, hamper service innovation and for the first time introduce de facto retail controls on broadband services in Europe.

An NRA's regulatory obligation for "wholesale equivalents", even covering new and enhanced service offerings, would moreover be counter to Article 12 (2) Access Directive in that it would require an SMP-operator to supply wholesale services even where:

- it would be technically and commercially feasible for alternative operators to provide such services themselves;
- the SMP operator's incentives for investment in wholesale facilities and its need to make a reasonable return on capital employed are at risk;
- the SMP operator's and others intellectual property rights might be violated.

Any obligation to provide a wholesale input requires a strict proportionality test to clearly justify an obligation to provide a "wholesale equivalent" in each individual case in view of the competitive situation on the relevant retail market and of all the alternatives ways to provide the service. Any obligation to unduly defer the introduction of new retail offers would also have a negative effect on innovation and competition, ultimately harming the consumer.

By proposing that NRAs can block innovative retail offers of a dominant operator in the wholesale market, the ERG is effectively proposing than an all-encompassing *ex ante* regulatory regime for retail broadband services.– This is to be done without requiring SMP on the downstream retail market – and at a time when the Commission proposes to deregulate retail services in the context of the Recommendation of relevant markets.

To suggest such a circumvention of the mechanisms of the NRF not only shows a worrying disregard for the EU legal framework and existing Commission guidance on *ex ante* regulation. It also risks stifling the remaining incentives for network upgrades to the end-users in the EU, potentially depriving users of the benefits of new and enhanced service offerings.

4. "Reasonableness of technical parameters and access"

The "problem" description in this chapter does not correspond to the principles of the NRF. When mandating access to networks, NRAs are to be guided by the relevant articles of the Access Directive and the overall objectives of the Framework.

In analysing technical and commercial terms and conditions for access, NRAs have to strike a balance between different goals of the Framework, such as fostering competition and preserving incentives for investment, and to take into account the technical feasibility of access (art. 12 (2) Access

Directive). To focus only on "maximising competition in downstream markets" is therefore only reflecting one of the goals of the Framework.

The imposition of access obligations has to be justified in view of the competitive situation on retail markets. A general obligation to meet all "reasonable" requests for access, depending on how it is interpreted, will lead to unnecessary and /or disproportionate forms of access which eventually lead to costs born by the consumer.

On the aspect of **reasonable terms of supply**, ETNO maintains that the SMP-operator should be in the position to negotiate contract conditions for its regulated wholesale offers which also cover its risks, for example, forecasting of demand is a crucial element to spread the risk adequately between access seeker and network operator.

5. "Fair and coherent access pricing"

As prices have signalling functions for investments and the further development of competition, markets are particularly sensitive to price-setting by regulators. Guidance on price-regulation should therefore be especially cautious and flexible to accommodate the conditions of competition in those markets where price regulation is still deemed necessary by NRAs.

ETNO is very concerned that the proposed approach to margin squeeze tests will create additional uncertainty and undermine remaining incentives for investment under the NRF.

- **Approach to margin squeeze - what relation between cost-based pricing and margin squeeze?**

The draft proposes that the level of access prices should be high enough "not [to] foreclose any realistic possibility of the development of alternative local access infrastructure" and to "incentivise efficient investment by […] the SMP player and competitors (…)". ETNO supports this statement.

However, the concept of a "minimum margin with relevant downstream services", related to an efficient new entrant is apparently in conflict with this approach and potentially with the practice of cost-based pricing followed by many NRAs with regard to LLU and Bitstream Access products. ERG seems to go beyond cost-based prices, trying to guarantee the competitiveness of an "efficient entrant". The draft talks about a "minimum acceptable margin" for services: prices should be low enough to allow for an acceptable minimum margin between various upstream services and also for an acceptable margin between downstream and upstream services. As retail prices are usually set by the market, a mechanical application of a set of "minimum margins" throughout the value chain **could** even **produce values** for the beginning of the value chain **which are below cost.** This result would be in breach of Art. 13 Access Directive.

In the same context, ETNO positively notes ERG's statement that where cost-based access is imposed, this should alleviate concerns about downstream margin squeeze – if this is the case, one wonders, however, why the Recommendations discussed above are made.

The statement seems to be contradicted as well later in the draft where it says that cost-based bitstream access may give rise to an "eviction price" with regard to upstream wholesale services and that "additional controls" may have to be imposed and where it is said that "it is not guaranteed that a cost-based price for unbundled loops and shared access will permit competitors to extend their networks." What is the solution proposed by ERG here?

Finally, the concept of an "**efficient entrant**" is used in models to test if prices deter market entry. The assumptions concerning the "efficiency" are disputable and often risk being subjective. ETNO believes it is not the NRF's goal to "guarantee" neither a certain margin nor the competitiveness of a so called "efficient" alternative operator. Moreover it is very vague what is meant to be an "efficient operator", because that depends to a great extend on the specific national circumstances and the operator's business model itself.

- **What relation between cost-based pricing and margin squeeze?**

ETNO positively notes ERG's finding that where cost-based access is imposed, this should alleviate concerns about downstream margin squeeze.

However, this statement seems to be contradicted by later in the draft where it says that cost-based prices for bitstream access may give rise to an "eviction price" with regard to upstream wholesale services and that "additional controls" may have to be imposed and where it is said that "*it is not guaranteed that a cost-based price for unbundled loops and shared access will permit competitors to extend their networks*."

- **Price regulation in the absence of "explicit" price regulation undermines regulatory certainty**

ETNO does not follow the logic of ERG in the following statement:

"*Whether or not there is an explicit pricing obligation, assurance of protection against downstream margin squeeze (or eviction pricing) is necessary. There needs to be reasonable certainty in advance of how a margin squeeze would be assessed and confidence that any complaint could in practice be resolved quickly.* "

If a market is considered requiring regulation in the presence of SMP, NRAs will have to analyse whether the conditions for price regulation under Art. 13 Access Directive are met. If there are no obligations concerning pricing, there is no need for an "indirect" obligation as ERG proposes: such price control would then be part of general competition law. Only if there is a stated need for sector-specific regulation – which has to be proven by the NRA - sector-specific remedies can be imposed.

The proposition of ERG would eliminate regulatory certainty and blur the borders to general competition legislation.

- **No divisional calculation of WACC unless this is reflected in the divisions own calculations**

ETNO proposes to not include in these documents the notion of differentiated risks for different operational units („*NRAs should consider whether to differentiate the risks borne by the SMP player in operating its access network from other risks of its business*.") This issue is subject of a separate consultation. We refer to ETNO's comments on the issue.[vii]

6. Reasonable quality of access products

The concept proposed by ERG in this passage is both far-reaching and overly general to have any relevance. The principles under this heading risk causing uncertainty regarding regulatory decisions in the field of quality of access products.

In particular, compensations for failure to deliver a certain quality of service should be governed by commercial agreements. The concept of "appropriate compensation" remains vague and should not be guiding regulatory decisions in this field.

7. "Assurance of effective and convenient switching processes"

This is a policy measure linked to the 'ladder of investment' concept promoted by ERG that in particular raises questions is that of so-called "migrations," or processes that allow for an access-based competitors to transfer from the use of indirect access wholesale services, such as wholesale line rental (WLR) or wholesale broadband access (WBA), to local loop unbundling.

One can observe a contradiction between the 'ladder of investment' concept and the supposedly separate relevant markets for broadband access and LLU under the EU regulatory framework. The premise for many NRAs' mandating several forms of network access was that alternative operators would not use them as substitutes for one another. The premise underlying 'migrations' is, conversely, that wholesale services and LLU are substitutes. This calls into question NRAs' market review analyses of the relevant markets and underlines the need for a consistent broadband access regulation that limits access to the remaining non-replicable bottleneck facilities, if any.[viii]

ETNO maintains that 'migrations' are not accommodated by the current SMP regime –governing mandated access to the SMP operator's fixed access network in most EU Member States – i.e., the composite of regulation resulting from EU NRF market reviews -- because that regime was derived from market analyses that demonstrated the separation between markets for Wholesale Broadband Access, Wholesale Narrowband Access, and Unbundled Local Loops.

8. "Assurance of backhaul from the point of delivery […]":

As stated above, under the NRF, a market analysis on market 12 or 11 cannot be guided by an "objective" that is largely related to a neighbouring market (here: leased lines). A market analysis on the related market is necessary to impose any obligations on backhaul services, where applicable and justified.

9. "Assurance of collocation at delivery points (e.g. ATM switches or IP BAS) and other associated facilities"

The focus of provision of such facilities under cost-orientation contradicts the regulatory framework: if there is a need for cost-oriented regulation, it has to be decided upon the results from the relevant market analysis and the specific market situation. To limit flexibility of NRAs by recommending the most far-reaching tool available, cost-oriented price regulation, before undertaking a market analysis is something that the EU regulatory framework does not allow.

Endnotes

[i] Framework Directive Section 8 (1); Access Directive Section 8 (4), Universal Service Directive Section 17 (2).

[ii] Commissioner Neelie Kroes speech at the Fordham Corporate Law Institute, New York, 23 Sept. 2005

[iii] ERG (06) 68, p.5

[iv] ERG (06) 68, p.11

[v] On the relationship between markets 12 and 11 and the related remedies, please see RD247 *ETNO Reflection Document on the Commission draft Recommendation on relevant product and service markets in the electronic communications sector* (Oct. 2006), p. 9 ff.

[vi] Commission Recommendation on relevant product and services markets, COM (2003) 497; On the ongoing discussion on newly emerging markets, ETNO would in particular like to point to studies by DIW and a paper presented by Indepen and Ovum commissioned by the Dutch regulator OPTA.

[vii] Reference to RD250 *ETNO Reflection Document on the ERG draft Principles of Implementation and Best Practice for WACC calculation* (Nov. 2006).

[viii] ETNO has explained this policy in detail in its RD227 *ETNO Reflection Document on re-assessing the "ladder of investment" in the context of broadband access regulation* (Sept. 2005).