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ETNO comments on the ERG draft common position on geographic aspects of market analysis

ETNO welcomes the ERG consultation on geographic aspects of market analysis. The Common Position is a positive step, as it acknowledges that the importance of geographic aspects of market analysis has increased over the last years and the relevance of having common principles at EU level.

ETNO regrets the relatively short consultation period provided for this very relevant and complex issue, which would have deserved a longer consultation to allow for full and comprehensive stakeholder contributions.

Executive Summary

- ETNO welcomes the ERG consultation and the recognition of the fact that geographic aspects of market analysis have increased over the last years. A proper application of geographic segmentation is key in order to ensure proportionate and targeted regulation in the EU.
- A proper application of the geographic segmentation concept should take into consideration the final goal of regulation to guarantee competition in retail markets. A too strong focus on competition “per se” in wholesale markets would ignore the competitive pressure exerted on consumer markets by the presence of cable operators for instance. This is particularly relevant in view of delineating geographic markets according to defined criteria which are too restrictive today.
- Geographic differences should be properly studied in the context of the development of NGANs. Given that the prospects of replicating these networks vary from one geographic area to another, regulation has to reflect these realities, and allow the development of infrastructure competition where possible. It is key that wholesale regulation of the SMP player does not weaken the business case for investing in next generation networks and /or upgrading existing infrastructures. Studying socio economic factors related to demand is a prerequisite in this context.

- ETNO basically agrees with the sequential process laid down in the consultation document. However, the first step: “preliminary analysis” does not seem to be needed, as there are markets, such as market 5 or market 6 that present clear differences between geographic areas. The preliminary analysis should not lead to a lack of appropriate study of geographic differences.
- In the ERG draft common position, ETNO is very concerned about the chapter on “possible implications” of sub-national markets or remedies. ETNO believes that if the market analysis is properly undertaken, the assessment of the possible implications has already been made in the market analysis.

General comments:

Currently, the concept of geographic segmentation is enjoying growing acceptance by the regulatory community, although some issues have to be taken into account for an optimal application of the concept, and to fully exploit its possibilities for having a more proportionate and targeted regulation in the EU. These aspects should also be further developed in the ERG common position:

- The focus and methodology of the market analysis process should bear in mind that the ultimate goal of regulation is competition in retail markets, to the benefit of the end user. Current criteria applied to define and deregulate geographic markets are too restrictive as the focus is mainly on trying to find competition in so-called “notional” (wholesale) markets. Although the ERG document probably represents an improvement regarding this issue as compared to the cases existing until now, ETNO suggests some ideas about this issue in the following.
- The main cases of full or partial deregulation due to geographical segmentation existing until now have been focused on legacy copper networks, and represent positive steps. However, the most interesting and challenging application of geographic segmentation (GS) will be for future development of NGANs. Having a proportionate and tailored regulation in each geographic area can substantially contribute to providing the right signals for investment in the different geographic areas for all players. The framework should encourage geographic segmentation with the intent to deregulate where possible.

Bearing in mind history and development of past access products, it would appear that not all forms of access products will be necessary and /or feasible in all geographic areas, as the prospects of replicability of networks may vary geographically. Regulation should recognise these facts and provide the right regulatory signals, in order to allow infrastructure competition to flourish where feasible, and help to expand the areas where infrastructure competition can develop. Recognition of this fact in the ERG document will be essential.

Comments on the specific points of the ERG document

Sequential process

The ERG document suggests the following sequential process:

- Preliminary analysis
- Choosing an appropriate geographic unit
- Assessing the homogeneity of competitive conditions
- Aggregate areas where competition conditions are sufficiently homogeneous
- Local geographic markets or differentiated remedies

ETNO basically agrees with the sequential process, but would like to highlight that a “preliminary analysis” as described in the document does not appear a necessary step. For some of the markets this is not needed, such as for market 5 or market 6 because they tend to show significant geographic differences in most Member States. A preliminary analysis risks pre-empting a proper geographic market definition if this step is carried out in a summary fashion.

It is important to highlight that the market definition process must be detailed and precise, in order to lead to market analysis decisions without ambiguities. According to the framework Directive, NRAs have to “define relevant markets appropriate to national circumstances, in particular relevant geographic markets within their territory”. That is why the preliminary analysis should not represent a back door to avoid a proper study of geographic variations of competition within a country.

1. Introduction

ETNO basically welcomes the introduction of the document, especially the recognition of the fact that the importance of Geographic Segmentation has increased in the last years and that geographic segmentation is important to better target ex-ante regulation. ETNO would like to point out that the importance of taking into account geographic differences in market analysis is likely to increase over the next years, as competition advances and investment decisions in NGANs are going to be taken by the different players.

The ERG opinion on NGANs quoted in the document recognises that: “...the economics of NGA networks are likely to vary across different technologies and different geographies ... and may lead to significantly different competitive conditions...”¹

¹ ERG (07) 16 Rev 2 ERG Opinion on Regulatory Principles of Next Generation Access, page 7

This fact should be further recognised and incorporated in the introduction and other parts of the document².

For today's framework and market situation, Ofcom's approach of segmentation on market 5 (wholesale broadband access) represents a first step to use geographic segmentation adequately. It led to a deregulation in significant parts of the identified markets. Also the decision of the Austrian NRA, to differentiate remedies according to geographic particularities proves the importance and economic impact of geographically heterogeneous areas. Therefore, ETNO believes that this approach can be adopted more widely.

The Portuguese NRA recently launched a consultation on Broadband Relevant Markets (Markets 4 & 5), proposing the introduction of market segmentation, in order to start a deregulatory process."

In particular in a future perspective in view of the realisation of NGAs, the markets that are susceptible to be studied in this context will include the local access unbundling market (currently market 4), as there are areas where there is access network infrastructure competition. Geographical segmentation in an NGA context should be flanked by a symmetric access regime for certain basic facilities required for network roll-out and covering wherever possible also facilities currently used for other purposes than electronic communications.

2. Is there a need for detailed geographic analysis?

As highlighted above, care should be taken that the necessary geographic market definition is not pre-empted by a 'preliminary analysis'. A thorough analysis of the geographic scope of the market analysis should be an integral part of the market definition process.

Evaluation of the need for geographic analysis should be mainly based on market situation in retail markets. The overall objective of regulation is to promote competition on the retail level. However competitive situation in the wholesale market does not always represent that of the retail market due to its characteristics. Cable TV operators (or ANOs with own infrastructure) for example are not providing wholesale services, however in some cases they play significant role on the retail side. As a result, due to infrastructure-based competition retail markets in most cases are much more competitive than wholesale markets.

E.g., the document says that a national uniform price of an operator with national coverage might have the effect that competitive pressure in some areas will be felt on a national level, and in those cases a detailed geographic analysis is not required.

² Regardless the fact that some legacy wholesale products, such as unbundling should be kept during a certain period of time

Although the point on common pricing constraint is further developed in section 4 of the document, this notion introduces a high uncertainty as to when a geographic analysis would be needed, and could be used in the future to skip a proper geographic market analysis. A typical situation in many MSs shows an incumbent operator subject to average wholesale price regulation that makes very difficult to de-average prices also at retail level. With this situation, movements of prices in competitive areas will have some type of impact on other areas, but this does not mean that competitive pressures are homogeneous. It would be mainly the consequence of having geographically averaged regulation.

Furthermore, operators offering nationwide services are faced with higher complexity and potential problems in communication and marketing/sales if they want to offer the same products at geographically different prices. Therefore a decision to de-average prices in certain geographies is primarily a business strategy decision of the company. As pricing is only one of many indicators within a geographic analysis, uniform pricing across a country does not allow the reverse conclusion of per-se non existing geographic markets.

On page 9, two cases are identified as indicators of the need of a geographic analysis. It could be added as another indicator when there are differences in the types of products and bundles offered in the market. Sometimes, competition is not focused on price, but on other parameters, such as quality, speed or type of package (including content) offered.

3. Choosing an appropriate geographic unit

ETNO basically agrees with the approach and the two general types of geographic units identified (related to network structure and administrative).

4. Assessing the homogeneity of competition conditions

Assessing the homogeneity of competition conditions should be made on clear and fact-based criteria according to which the geographic units are classified and grouped.

Barriers to entry: ETNO agrees that a proper assessment of barriers to entry should include an analysis of factors related to demand, such as total income, household density, business site density, etc. Experience shows that the aforementioned socio economic factors influence the distribution of investment of players and the degree of competition.

While a forward looking analysis should include the plans and forecasts of the different operators to unbundle switches or buy wholesale services, the socio economic factors related to demand should be a key element of the analysis, as these are the key issues that the different players take into account for investment decisions. Where as a result of such analysis the deployment of several parallel infrastructures appears viable in an area this

should be fully recognised in the analysis of homogeneity of competition conditions, even if operators do not yet present concrete roll-out plans.

This also appears appropriate as forward-looking NRA decisions should not rely only on a subjective prognosis of market players (whether established or alternative operators) which in itself can be subject to strategic behaviour.

Number of suppliers: The number of infrastructure providers (whether based on xDSL, cable, WLAN,...) available to end-customers is an important factor for assessing competition. However, rather than the absolute numbers of alternative suppliers what is more important are these players' characteristics in terms of strength (market share, network coverage, ...) and sustainability. Then to adequately assess competitive pressures, it should be looked at the availability of all types of alternative offerings based on alternative networks such as cable networks or fibre whereby retail customers can easily switch providers.

In this respect, the draft ERG CP mainly highlights the importance of unbundlers for wholesale BB access and "other forms of network reach" analysis for terminating segments of leased lines.

While the number of unbundlers is certainly important for the wholesale broadband market analysis, the presence of cable operators or fibre operators also strongly influences the behaviour of the SMP player in the wholesale broadband market.

The two main national cases of a geographic approach to wholesale BB by NRAs have considered on equal footing presence of unbundlers and CATV operators³.

Regarding this issue, it is necessary to bear in mind that the final goal is competition at retail level. That is why competition provided by alternative infrastructures, such as cable operators should also be given a key role, as the competitive impact on retail competition is usually more important than other operators that rely on wholesale services. Presence of cable or fibre operators should not only be taken into account in this market, but should also be given a higher importance, as it reflects a lower level of entry barriers, and a more sustainable type of competition.

The statement in the consultation document that only important players or those that have certain coverage at national level should be taken into account should be reconsidered. For example, in many places there are "local" cable operators, which cover a city or a province, but exert significant competitive pressure in their coverage areas. Examples: Three cable operators that may be considered "local" in Spain have more than 40% BB market share in their provinces⁴. This also holds true for a considerable amount of cities in The Netherlands. In Belgium, the cable TV operator that

³ Beyond a certain coverage threshold for CATV operators.

⁴ According to CMT's report about penetration of telecommunications services, July 2008.

is active only in the northern half of the country has a broadband market share exceeding 50% in its franchise area.)

In Germany, the competitors using ULL have - except for two-three national competitors - mainly regional business cases. In the respective areas, such as Cologne or Munich, regional operators gained increasing market shares up to 40-50%, leading to clearly distinct conditions of competition in these areas.

In Austria the inclusion of cable operators leads to a deregulatory decision in certain urban areas for market 5 as unbundlers and cable companies have more than 60-70% market share in major cities.

In Sweden and Denmark there is a significant growth of particularly fibre customers in specific areas which in Denmark amounts to more than 40% of household having broadband access using other technologies than DSL

In Portugal, cable operators (although some of them with limited geographic presence), have in total very strong national presence in the broadband market with a market share of 41.2%, while Portugal Telecom has a market share of 37.3%⁵. In some major cities, cable operators are dominant and are in advantage in offering triple play solutions due to their position in TV contents.

In addition in some countries like Austria, Italy or the Nordics countries, mobile services for voice and broadband access have emerged very rapidly and gained an enormous market share. In countries where this is the case competitive pressure from mobile has to be taken into account within the market analysis procedure, nationwide as well as on a regional basis.

Pricing and price differences: We basically share the ERG analysis of the issue of price differences: they are an indicator of variation in competitive pressures, but there are cases where a uniform national price does not mean that the market is necessarily national. We welcome the development made of this point (page 14 of the consultation document): on incentives to set a national price, and on the need of a modified greenfield approach when the existence of a uniform price is the result of an average SMP regulation.

ETNO fully supports taking into consideration not only the SMP operator prices, but also the prices of other operators.

The ERG document says that in wholesale markets prices might not always be observable or available and that in such cases it might be helpful to consider retail prices. It should be pointed out that the final goal of regulation is having competition for final users, and consequently one of the most important factors to take into account is price competition at retail level. Even if there are no variations of wholesale prices, variations of retail prices should be taken into account for the analysis of wholesale markets⁶.

⁵ Source: ICP-ANACOM, 1st Quarter of 2008

⁶ Commission's comments on case UK/2007/0733: *...In addition, evidence of differentiated **retail or wholesale** pricing which might apply could help indicate different regional or local competitive pressure...*

On the other hand, it is clear that having price differences at wholesale level is an indication of variation in competitive conditions, but sometimes the wholesale service has so little importance, that it is not even relevant from the point of view of pricing. That is the case, for instance, for wholesale BB access in the competitive areas, when there is a considerable degree of infrastructure competition and/or unbundling. In such areas, bitstream is almost non-existent, simply because operators do not use it any longer. Prices may not present variations, but because the market is almost non-existent.

Which areas should be aggregated?: ETNO welcomes the principle laid down in the ERG document: it is likely that some error in grouping may occur but the other alternative – a geographically uniform treatment- could result in much larger errors.

In fact, the average treatment that is happening now in many markets is providing a regulation based on average market conditions that do not properly match real market conditions. The reality of the markets shows variation from some geographic areas to others, but all of them are currently treated as if they reflected the “average” situation from the regulatory point of view. This underlines the need for a stronger role of geographical segmentation in regulatory practice.

Changes in geographic market boundaries over time

ETNO welcomes the principle that NRAs should undertake a forward-looking analysis. However, a forward looking analysis should also foresee taking into account the socio-economic factors related to demand mentioned in point 4 of the ERG document (s. above).

Especially important for the development of NGN/NGANs is taking into account the prospects for the deployment of infrastructure competition in the different geographic areas. The competitive conditions across a national market vary according to the demographic and economic conditions. In the context of economics of NGANs, the number of alternative networks that can viably be deployed will vary accordingly. A proper regulatory approach should adjust regulation (markets and/ or remedies) in order to maximise the possibilities of investment in infrastructures and achieving infrastructure competition.

It is key that wholesale regulation of the SMP player does not diminish the business case of the players to invest and /or upgrade next generation infrastructures.

5. Local geographic markets or differentiated remedies?

ETNO generally agrees with the principle that markets vs. remedies should not be viewed as two alternative, equally applicable options. Geographic market definition is determined by the evidence from the analysis.

It is likely that competition could be more vibrant in some areas than in others, and that one operator might still have national SMP. In such a situation, more room for the SMP operator to compete in the more competitive areas can have positive welfare effects. Variation in remedies can be a more flexible way to achieve this. However, if the analysis points towards existence of geographic markets, the NRA should define and analyse them accordingly.

Regarding the conditions for delineating and defining geographic markets, two closely linked issues are worth mentioning in this context: competition at retail level and self-supply.

- **Competition at retail level**

While geographic market definition has to be carried out in line with the principles of the EU framework, the purpose of market definition is its applicability to ex-ante regulation which aims at achieving competitive retail markets for ensuring choice, low prices and quality to end-users.

Most of the time, the geographic market definition is made on so-called “notional” wholesale markets, that are defined as markets, but the purpose of which is the provision of a wholesale product to enable competition at the retail level. Losing sight of this reality and applying a strict demand and supply side substitution analysis for defining wholesale markets that loses sight of the consequences at retail level is problematic as can be seen from the decision making practice of the European Commission in this field.

Trying to find evidences of competitive behaviours in the relevant wholesale market, will not be possible or not be necessary in all cases, as the demand for wholesale services is mainly driven by the interest of buyers to provide retail services.

- **Self-supply**

In this context, ETNO would like to highlight that consideration of self-supply is key in order to have a proper assessment of competitive constraints on SMP players, and, in particular, a proper delineation of geographic markets. The ERG common position should recognise this fact and duly recognise the importance of including self-supply of alternative operators in the relevant product market.

If self-supply of alternative operators is excluded from the product market definition phase – or the conditions for its inclusion are overly restrictive -, the number of competitors will always be zero in all geographic areas and

the established operator's market share will always be 100%. This would render impossible a proper delineation of geographic markets and would undermine the assessment of the need for ex-ante regulation (Three-Criteria-Test), since the market would be de facto considered to be non-contestable although barriers to entry have been sufficiently low to allow third parties to provide the services in question.

An alternative view developed about this issue, for instance in the relevant markets Recommendation, is to consider self-supply of alternative operators only in certain circumstances, when there is demand substitution, i.e. where wholesale customers are interested in procuring from alternative operators (approach not valid if alternative operators face capacity constraints, or their networks lack the ubiquity expected by access seekers, and/or if alternative providers have difficulty in entering the merchant market readily)⁷.

However, these conditions are unjustified (s. arguments on retail competition above) and would amount to make inclusion of self-supply unduly difficult. In these cases, the context of the merchant wholesale market could lead alternative operators to consider that wholesale offers are less interesting to be developed for a variety of reasons:

- The market may not practically exist, for instance, the bitstream market may be irrelevant in geographic areas where there is substantial presence of cable and unbundlers.
- The level of regulated wholesale prices may make the case for alternative operators to provide wholesale services very weak (or for current customers to switch to other providers)
- The importance of the wholesale market customers may vary from national market to national market. In some national markets, large ISPs which are typical buyers of these services are integrated in large operators, and almost non-existing. Other Member States may show an important base of ISPs.

What is important in these cases is to consider competitive pressures at retail level, and not lose sight that the wholesale markets that NRAs are analysing are "notional" markets⁸.

As a general assessment of point 5 of the consultation document, a stronger focus should be placed on differences in market shares and competition at retail level. Although it is quoted as an example at the end of page 18, the issue of a common pricing constraint gives the impression that it would be the "key" factor to decide between geographic markets vs. remedies. The document should be modified to acknowledge that in some cases, having uniform prices does not necessarily mean that the market has to be defined as national, as discussed in the ERG document on page 14.

Possible implications

⁷ Relevant markets Recommendations, explanatory memo, page 15.

⁸ Idem

The consultation document puts a strong emphasis on the study of the impact on competition of a geographic approach to regulation (remedies or markets).

ETNO is very concerned with several of the considerations made in this chapter. ETNO believes that if the market analysis is properly undertaken according to the principles of the EU framework, and taking into account the purpose of ex-ante regulation, this analysis of implications has already been made in the market analysis.

For example, the mentioned impact on competition in business services resulting from a withdrawal of regulation in geographical market segments cannot justify maintaining averaged regulation despite an analysis leading to different geographic markets. If geographical segmentation severely affects competition for business customers, this is an indication that a separate market for the according products should have been defined at the product market definition level.

Also it is unclear in how far differentiated price regulation may have impacts on other markets requiring that “prices at different levels of the value chain are consistent” and potentially justifying “the maintenance of national prices in these other markets” (p. 19). Regulation will need to be adapted to the conditions of competition in a given geographical market. This may lead to regulated wholesale products being available in one geographical markets but not in others. Where regulation is targeted at the economic bottleneck in a given geographical market, it may therefore rather simplify price regulation by alleviating the need for a complex pricing regime balancing the prices of several wholesale products.

An impact analysis should include an analysis of the implications of maintaining an average regulation despite differing competition conditions in at least the same way as the analysis of the impact of introducing geographical segmentation on which this chapter seems to focus. Maintaining an average regulation when evidences of competition variations have been observed introduces market distortions that affect operators’ behaviours and investment decisions, leading to the corresponding impact on final users.